No. 16-1215

IN THE

Supreme Court of the United States

LAMAR, ARCHER & COFRIN, LLP,
Petitioner,

v.

R. SCOTT APPLING,
Respondent.

On Writ of *Certiorari* to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF *AMICI CURIAE* THE HONORABLE EUGENE WEDOFF (RET.) AND A GROUP OF LAW PROFESSORS IN SUPPORT OF RESPONDENT

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iv
INTEREST OF THE *AMICI CURIAE*	1
SUMMARY OF THE ARGUMENT	7
ARGUMENT	9
I. The availability of a discharge is of critical importance to individual debtors, to the larger economy, and to the proper functioning of the bankruptcy system	9
A. The correct interpretation of 11 U.S.C. § 523(a)(2)(A) should begin with the economic and contextual importance of the bankruptcy discharge for the individual debtor	9
B. The correct interpretation of 11 U.S.C. § 523(a)(2)(A) should reflect the fiscal and contextual importance of the bankruptcy discharge on the larger economy	12
C. Chapter 7 debtors frequently lack legal counsel for discharge litigation, which leaves them vulnerable to unwarranted settlement pressure	14
II. Section 523(a)(2)(A) should be interpreted broadly to mean that the exception to nondischargeability may include an oral statement about a single asset	17

TABLE OF CONTENTS—Continued

Page

A. Section 523(a)(2)(A) expressly adopts a broad notion of what is dischargeable by use of the word "respecting" to modify financial condition 17

B. Prior to the adoption of the Code in 1978, most circuit courts generally interpreted "respecting financial condition" as applying to more than a formal financial statement 19

C. The meaning of "financial condition" cannot be determined by reliance on the definition of "insolvency" in Code § 101. The definition of equitable insolvency provides a better tool for interpreting "financial condition." 23

III. The legislative history demonstrates that Congress has been expanding protection against loss of the discharge and that § 523(a)(2)(A) was intended to have a broad meaning 25

A. "Financial condition" has been broadly defined since the passage of the Bankruptcy Act in 1898 27

B. In 1960 and 1978, Congress added greater debtor protection from loss of the discharge in view of creditor abuse of the discharge provisions 30

CONCLUSION 34

TABLE OF CONTENTS—Continued

APPENDIX — Page

Bankruptcy Act of 1898, § 14, 30 Stat. 544 ... 1a

Act of February 5, 1903, ch. 487, § 4, 32 Stat. 797 ... 2a

Amendment of the Bankruptcy Act, S. Rep. No. 61-691 (1910) ... 4a

Establish a Uniform System of Bankruptcy, H. Rep. No. 69-1257 (1926) ... 7a

Act of May 27, 1926, § 6, Pub. L. No. 69-301 44 Stat. 662 ... 10a

Act of June 22, 1938, Pub. L. No. 75-696, § 14, 52 Stat. 850 ... 12a

Limiting the Use of False Financial Statements as a Bar to Discharge in Bankruptcy, H. Rep. No. 86-1111 (1959) ... 15a

Limiting the Use of False Financial Statements as a Bar to Discharge in Bankruptcy, S. Rep. No. 86-1688 (1960) ... 22a

Act of July 12, 1960, Pub. L. No. 86-621, 74 Stat. 408 ... 33a

Bankruptcy Law Revision, H. Rep. No. 95-595 (1977) ... 35a

Act of November 6, 1978, Pub. L. 96-598, §§ 523-524, 92 Stat. 2590 ... 55a

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Albinak v. Kuhn,
149 F.2d 108 (6th Cir. 1945) 20, 21

District of Columbia v. Greater Washington Bd. of Trade,
506 U.S. 125 (1992) 18

Field v. Mans,
516 U.S. 59 (1995) 3, 31, 32

Heald v. District of Columbia,
254 U.S. 20 (1920) 22

In re C.F. Foods, L.P.,
280 B.R. 103 (Bankr. E.D. Penn. 2002) ... 25

In re Cook,
46 B.R. 545 (Bankr. E.D. Va. 1985) 22

In re Dolata,
306 B.R. 97 (Bankr. W.D. Pa. 2004) 24

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502 F.3d 61 (2d Cir. 2007) 7

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427 F.3d 700 (10th Cir. 2005) 3, 24

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No. 09–07030JAD, 2010 WL 8354696
(Bankr. W.D. Pa. July 1, 2010) 24

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45 B.R. 681 (Bankr. W.D. Tenn. 1985) 22

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Page(s)

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246 F. 228 (1917) 28, 29, 30

Jerman v. Carlisle, McNellie, Rini, Kramer & Ulrich LPA,
559 U.S. 573 (2010) 22

Key v. Doyle,
434 U.S. 59 (1977) 22

Lemon v. Kurtzman,
403 U.S. 602 (1971) 18

Local Loan Co. v. Hunt,
292 U.S. 234 (1934) 6

Lockhart v. Edel,
23 F.2d 912 (4th Cir. 1928) 19

Mau v. Sampsell,
185 F.2d 400 (9th Cir. 1950) 20

Moody v. Sec. Pac. Bus. Credit, Inc.,
971 F.2d 1056 (3d Cir. 1992) 24

Rake v. Wade,
508 U.S. 471 (1993) 17

Shainman v. Shear's of Affton, Inc.,
387 F.2d 33 (8th Cir. 1967) 20

Shaw v. Delta Airlines, Inc.,
463 U.S. 85 (1983) 18

Smith v. United States,
508 U.S. 223 (1993) 18

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Page(s)

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STATUTES

11 U.S.C.A. § 32 20

Act of 1898, § 14b(2), 30 Stat. 544-550 27

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Act of May 27, 1926, Pub. L. 69-301, ch. 406, 44 Stat. 662-63 ..... 19, 29

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U.S. Bankruptcy Code, 11 U.S.C. § 101 *et. seq.* ..... *passim*

§ 101(32) 23

§ 523(a)(2) 18, 33

§ 523(a)(2)(A) ..... *passim*

§ 523(a)(2)(B) 22

§ 548(a)(1)(B)(ii) 24

§ 548(a)(1)(B)(ii)(III) 24

TABLE OF AUTHORITIES—Continued

LEGISLATIVE MATERIALS Page(s)

H. Rep. No. 69-1257 (1926) 19, 29

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INTEREST OF THE *AMICI CURIAE*[1]

The *amici curiae,* whose names are set forth below, include a former bankruptcy judge and law professors at various universities where they teach courses on bankruptcy law, conduct research, and are frequent speakers and lecturers at seminars and conferences on bankruptcy law.

The Honorable Eugene Wedoff (ret.) served as a U.S. Bankruptcy Judge in the Northern District of Illinois in Chicago from 1987-2015 and as Chief Judge from 2002-07. Before his judicial service, Judge Wedoff was a partner and member of the executive committee of the Chicago law firm of Jenner & Block. He served as a member and as the chair of the Advisory Committee on Bankruptcy Rules from 2004 to 2014, and as a governor, secretary, and president of the National Conference of Bankruptcy Judges through 2015. He is currently president of the American Bankruptcy Institute. He is a Fellow of the American College of Bankruptcy and a member of the National Bankruptcy Conference.[2]

Margaret Howard is the Law Alumni Association Professor of Law, Emerita, at Washington and Lee University School of Law, Lexington, Virginia. She

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[1] Pursuant to this Court's Rule 37.3(a), both parties sent a letter or email granting consent to this *amici curiae* brief. Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part, and that no person other than *amici* or their counsel contributed any money to fund its preparation or submission.

[2] The views set forth herein are the personal views of Judge Wedoff and the named *amici* and are not necessarily the views of the American Bankruptcy Institute, which has not participated in any way in this appeal.

has taught and conducted research on topics in bankruptcy law for more than three decades, with an emphasis on discharge issues in consumer bankruptcy. She holds a B.A. from Duke University, a J.D. and M.S.W. from Washington University in St. Louis, and an LL.M from Yale University. She has served as the Scholar in Residence at the American Bankruptcy Institute, and as the ABI's Vice President in charge of the Research Grants Committee. Professor Howard is a fellow of the American College of Bankruptcy and the American Law Institute.

Professor Jack F. Williams is a professor of law at Georgia State University and the Center for Middle East Studies, where he teaches and/or conducts research on bankruptcy and business organizations; mergers and acquisitions; and taxation and statistics. He is the Association of Insolvency and Restructuring Scholar in Residence. He is a fellow in the American College of Bankruptcy. He holds a B.A. in economics from the University of Oklahoma, a J.D. with High Honors from George Washington University National Law Center, and a Ph.D in archaeology from the University of Leicester in Leicester, United Kingdom.

David R. Kuney is an Adjunct Professor at the Georgetown University Law Center where he teaches bankruptcy law. He has taught at American University's Washington College of Law and at New York Law School. He was formerly a partner at the law firm of Sidley & Austin. He currently serves on the Board of Directors of the American Bankruptcy Institute. He is a fellow in the American College of Bankruptcy.

Your *amici* are submitting this brief out of a concern that the discharge provisions of the Bankruptcy Code not be interpreted in such a fashion as to cause unwarranted economic injury to individual debtors

nor to the larger economy. We write because Petitioner has offered an interpretation of the Code and a view of debtors that we believe is decidedly incorrect and will cause economic harm to many.

The central issue in this case concerns the correct interpretation and application of one of the key discharge provisions in the U.S. Bankruptcy Code,[3] namely, 11 U.S.C. § 523(a)(2)(A). This provision states that the Code prohibits the discharge of "any debt . . . for money, property, [or] services . . . to the extent obtained by . . . false pretenses [or] false representation . . . *other than* a statement respecting the debtor's . . . financial condition" (emphasis added).

Petitioner argues that the phrase "other than" only excludes from the rule of non-dischargeability a debt obtained by an oral misrepresentation that is tantamount to a "standard" financial statement, e.g., statements that reflect a debtor's overall assets and liabilities.[4] Oral statements about a debtor's individual assets or debts, large or small, material or not, would potentially bar a discharge, in Petitioner's view. Debtors would be subject to a discharge challenge based on oral statements, often made many years earlier, for which there is no written evidence and without any showing of reasonable reliance.[5]

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[3] 11 U.S.C. § 101 *et. seq.* (the "Code").

[4] *See, e.g., In re Joelson*, 427 F.3d 700, 707 (10th Cir. 2005) (describing the limited view that the phrase "statement respecting the debtor's . . . financial condition" as used in § 523(a)(2)(A) means "a debtor's net worth or overall financial condition.").

[5] *See Field v. Mans*, 516 U.S. 59 (1995) (requiring the lesser showing of "justifiable reliance").

The Eleventh Circuit held the opposite, finding that an alleged oral misrepresentation concerning even a single asset may still be a statement "respecting" or "related to" one's financial condition, and hence may not serve as the basis to bar a debtor's discharge. This view was, until recently, the majority view.[6] The Solicitor General, representing the United States as the largest creditor in bankruptcy matters, agrees. S.G. Opp. Br. 21. So do we.

Petitioner's opening sentence describes Mr. Appling as one who lied to his attorneys and references to lying appear four times in the first paragraph. Pet. Br. 2. Petitioner also argues that the Eleventh Circuit's ruling would permit a "truck" to be driven through the Code's discharge provisions. Cert. Pet. 2. Implicit in this opening argument is a view of debtors, collectively, as "can-pay" individuals who will opportunistically seek to game the system when given the chance. Petitioner's brief is premised on this unflattering view of the population of individual debtors and a notion that Congress has sought to rein in misconduct by ever stricter views of who deserves a discharge.

Petitioner's view of both debtors collectively and of Congressional response to the discharge issue are decidedly inaccurate. We urge a different view and one widely supported by the existing empirical data, which is missing from Petitioner's brief. The large body of economic data on the true nature and purpose of the discharge for individual debtors in the bankruptcy system discloses not only a bona fide need

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[6] See *In re Powell*, 423 B.R. 201, 210 (Bankr. N.D. Tex 2010) ("Other courts (and the emerging majority of cases) adopt a more liberal view. Those courts have defined the phrase to encompass a much broader class of statements, even those which relate to a single asset or liability.").

for discharge protection, but the macroeconomic value that relieving debt has on the general economy. Congress is aware of this plight and Congressional statements, as well as the legislative movement, over the past 60 years, have sought to broaden protection of the discharge. The Eleventh Circuit correctly perceived this.

The bankruptcy discharge goes to the very heart of bankruptcy law and deeply affects its administration, outcome, and social value. "[T]he introduction of the discharge [into modern bankruptcy law] could well be considered the single most important event in bankruptcy history." Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* 20 (1989). Indeed, commentators have observed that the bankruptcy discharge "ranks ahead in importance of all others in Anglo-American bankruptcy history." John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History*, 70 Am. Bankr. L.J. 163, 164 (1996).

This case has widespread importance to potentially millions of individual Chapter 7 debtors because of its potential to deny a discharge for debtors and to change the law in many jurisdictions.[7] Individual debtors who seek bankruptcy relief have been well-studied and their economic plight analyzed with statistical care: "when bankrupt debtors as a group are compared to the general population, their situations are grim."

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[7] The number of non-business bankruptcy filings in 2017, 2016, and 2015 was as follows: 770,901, 808,781, and 911,086, respectively. *March 2017 Bankruptcy Filings Down 4.7 Percent*, United States Courts (Apr. 19, 2017), http://www.uscourts.gov/news/2017/04/19/march-2017-bankruptcy-filings-down-47-percent [https://perma.cc/LB7B-CAEA].

Sullivan et al., *As We Forgive Our Debtors*, *supra* at 77. The data shows "a segment of America in financial collapse." *Id.*

Petitioner's harsh rule strays far from the underlying principles expressed by this Court over eighty years ago, in which this Court held that bankruptcy discharge is an essential aspect of one's financial and personal "liberty." *Local Loan Co. v. Hunt*, 292 U.S. 234, 245 (1934).

> The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve the free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern . . . . The new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite period of time in the future to the payment of indebtedness incurred prior to his bankruptcy.

The underlying principles of *Local Loan* pertain here, as does long-standing practice and the words of the Code. For these reasons set forth below, the Eleventh Circuit's decision should be affirmed.

SUMMARY OF THE ARGUMENT

The Bankruptcy Code, at 11 U.S.C. § 523(a)(2)(A), prohibits a discharge of "any debt . . . for money, property, [or] services . . . to the extent obtained by . . . a false representation . . . other than a statement respecting the debtor's . . . financial condition." The question presented in this case is whether the phrase beginning with "other than" should be broadly interpreted to mean a statement concerning even a single asset or whether it should be narrowly construed to mean only a statement regarding the debtor's overall financial condition. The better-reasoned rule, and the rule consistent with congressional intent and sound bankruptcy policy, is that § 523(a)(2)(A) *may* include a statement concerning even one asset where that statement bears on the debtor's ability to perform or pay the relevant transaction. Accordingly, the decision of the Eleventh Circuit should be affirmed for the following reasons:

First, the proper judicial interpretation of § 523(a)(2)(A) requires consideration of the underlying economic rationale of the bankruptcy discharge, as well as the statutory language used by Congress. One informs the other. The ability of an individual consumer debtor to obtain a discharge in bankruptcy has been said to be a matter of economic life and death. "The consequences to a debtor whose obligations are not discharged are considerable; in many instances, failure to achieve discharge can amount to a financial death sentence." *In re Hyman*, 502 F.3d 61, 66 (2d Cir. 2007). Petitioner's overly narrow view of § 523(a)(2)(A) injures not only individual debtors, but also has a demonstrated harm to the macro economy by discouraging family formation, educational expenditures, and overall participation in the economy.

Second, the statutory language of § 523(a)(2)(A) fully demonstrates a broader reading of the protection for the discharge. The phrase "respecting financial condition" was first introduced into American bankruptcy law in 1926. Virtually every circuit court that interpreted this section prior to adoption of the Code in 1978 held that the phrase was *not limited* to only a formal financial statement. Petitioner's reliance on the Code definition of "insolvency" as somehow supplying the definition of "financial condition" is unsound and contradicted by other Code-based definitions of insolvency that suggest a different outcome.

Third, the legislative history likewise shows that Congress has been moving steadily toward broader protection of the discharge for individual debtors. The key terminology, such as "financial condition" and "false statement" were untethered to any notion of a formal financial statement. Indeed, when Congress enacted the 1978 Code, the Bankruptcy Commission created to recommend changes to the bankruptcy law was so concerned over creditor abuse of the "financial condition" provision that it "recommended that this exception to discharge be eliminated for consumer debts." H. Rep. No. 95-595 (1977). App. 47a. While Congress did not eliminate it, Congress did strictly limit the ability to challenge the discharge in new § 523(a)(2)(A). It is inconceivable that the Code should now be read as making the discharge *less available* when Congress was seeking exactly the opposite outcome.

Accordingly, we urge this Court to affirm the decision of the Eleventh Circuit.

ARGUMENT

I. The availability of a discharge is of critical importance to individual debtors, to the larger economy, and to the proper functioning of the bankruptcy system.

A. The correct interpretation of 11 U.S.C. § 523(a)(2)(A) should begin with the economic and contextual importance of the bankruptcy discharge for the individual debtor.

The discharge provisions of the Code were not drafted in a vacuum; they were instead manifestly responsive to perceived economic distress. Thus, a proper interpretation of § 523(a)(2)(A) must reflect the bankruptcy discharge's impact on the individual debtor, the larger social and economic benefits of the discharge, and Congressional recognition of these values. "[T]he [Bankruptcy] Act must be liberally construed to give the debtor the full measure of the relief afforded by Congress, lest its benefits be frittered away by narrow formalistic interpretations which disregard the spirit and the letter of the Act." *Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 279 (1940) (internal citations omitted).

Petitioner argues that the rule announced by the Eleventh Circuit undermines the primary operation of § 523(a)(2)(A) "by creating a loophole through which dishonest debtors might relieve themselves, at honest creditors' expense, of liabilities incurred through fraud." Cert. Pet. 21. Petitioner argues that the broad rule would permit debtors to "drive a truck" through the intended policy of Congress. *Id.*

All of these contentions are lacking in any empirical data to support the notion of meaningful debtor abuse.

Indeed, Petitioner offers no support for the view that Chapter 7 debtors are in any position to "drive a truck" through Code-based policies nor that such debtors even exist.

Instead, empirical data demonstrates that the typical Chapter 7 debtor seeks bankruptcy protection due to a grim and serious economic plight, rather than misconduct, over-spending, or other non-productive economic conduct. Economic relief in the form of a discharge is of critical importance, and often protects the debtor from health and life-risking choices, such as between medical treatment and food.[8] This is important because one in ten Americans has filed for either a Chapter 7 or a Chapter 13 bankruptcy. Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *The Fragile Middle Class: Americans in Debt* 22 (2000).

When asked why they filed for bankruptcy 67.5 percent of debtors reported job loss, 19.3 percent cited a medical event, and 22.1 percent listed family concerns (i.e. divorce) as contributing factors that led to their bankruptcy. *Id.* at 16 fig. 1.2. These Americans file for bankruptcy not because it is "an easy way out," but because they have run out of options. Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data*, 1983 Wis. L. Rev. 1091, 1138 (1983).

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[8] One of the largest single causes for the filing of Chapter 7 bankruptcy by individuals is catastrophic medical issues, such as cancer, automobile and industrial accidents, and age-related issues. Maurie Backman, *This Is the No. 1 Reason Americans File for Bankruptcy*, The Motley Fool (May 1, 2017), https://www.fool.com/retirement/2017/05/01/this-is-the-no-1-reason-americans-file-for-bankrup.aspx [https://perma.cc/M8WA-2WQ8].

Debtors who seek bankruptcy protection earn much less money and owe much more than the average American. Robert M. Lawless, et. al., *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 Am. Bankr. L. J. 349, 371–72 (2008).

> [The] median household income for bankrupt debtors in 2007 was about $27,100—statistically indistinguishable from the $27,800 in 2001 and $27,100 back in 1991. Median household income across the United States in 2006 was $48,200. These figures put the income of the median bankrupt household in 2007 a full 45% below the income of the median household in the general U.S. population.

Id. at 363.

Only a small fraction of debtors had any hope of repaying their debt outside of bankruptcy. Even those debtors who voluntarily attempted repayment in Chapter 13 were in terrible shape: at most, only about a third were able to complete their repayment plans, and a significant portion of those debtors were making only minimal repayments. *See* Teresa A. Sullivan, Elizabeth Warren, & Jay Lawrence Westbrook, *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981–1991*, 68 Am. Bankr. L.J. 121, 123 (1994).

The discharge provisions have proven to be effective. Debtors who obtain a discharge are generally restored to a productive role in the larger economy. Empirical studies support the concept of fresh start. Indeed, "the average person who files for bankruptcy to relieve financial stress catches up with their peers." Jay L. Zagorski & Lois R. Lupica, *A Study of Consumers'*

Post-Discharge Finances: Struggle, Stasis, or Fresh-Start? 16 Am. Bankr. Inst. L. Rev. 283, 289 (2008).[9] "One study compared bankruptcy filers with non-filers regarding key economic factors such as car ownership and debt, home ownership and debt, savings, credit card ownership, income, and work." *See id.* at 296. "None of the data indicate that over time the size of the financial gap between bankruptcy filers and non-filers either gets wider or stays the same; for the most part, the size of the financial gap between these two groups narrows over time." *Id.* at 307. Thus, empirical research establishes that the discharge provisions achieve the key goal of restoring individuals to economic capacity.

B. The correct interpretation of 11 U.S.C. § 523(a)(2)(A) should reflect the fiscal and contextual importance of the bankruptcy discharge on the larger economy.

The bankruptcy discharge benefits the larger economy while aiding the individual. Petitioner incorrectly posits the bankruptcy discharge as a benefit only to the individual debtor, and then, only on a strict condition of "honesty." This misses much of the point about the importance of the discharge. The discharge also has macro consequences which benefit the larger economy. "The theory is that society as a whole benefits when an overburdened debtor is freed from the oppressive weight of accumulated debt. The debtor then is able to resume his or her place as a productive

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[9] *See also* Katherine Porter & Deborah Thorne, *The Failure of Bankruptcy's Fresh Start*, 92 Cornell L. Rev. 67, 87 (2006) ("The majority, 65% of families, reported that their financial situations had improved since they filed bankruptcy.").

member of society." Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 Am. Bankr. L.J. 325, 364–65 (1991). Essentially, "the bankrupt becomes a clear man again; and, by the assistance of his allowance and his own industry, may become a useful member of the commonwealth." 2 *William Blackstone, Commentaries* *484.

Additionally, "it has been noted that the Chapter 7 debt discharge prevents the development of an insolvent underclass and incentivizes entrepreneurship by offering a mandatory insurance policy for failed business endeavors." Amber J. Moren, Note, *Debtor's Dilemma: The Economic Case for Ride-Through in the Bankruptcy Code*, 122 Yale L.J. 1594, 1618 (2013). This in turn encourages investment and economic stability.

While the discharge has a beneficial effect on the macro economy, the availability of a discharge for individual debtors has no significant impact on small business owners. The notion that the bankruptcy discharge has a significant adverse effect on small businesses is untrue, despite assertions of one *amici* in this case suggesting that the Eleventh Circuit rule is "fraudster friendly" and will injure small business. *See* NFIB Br. 17. The lack of bankruptcy harm to small business can be seen in the very polling data that the NFIB cites in its amicus brief, showing that only four percent of small businesses consider bankruptcy a cause of customer non-payment. *NFIB National Small Business Poll Getting Paid* 3 (William J. Dennis, Jr. eds., 2001), http://www.411sbfacts.com/files/gettingpaid[1].pdf [https://perma.cc/CDZ7-PX6T]. This was only slightly greater than the "cost of using credit cards" at 2.9%. *Id.* Ninety-seven percent of all small business owners do not expect to encounter more

than one bankruptcy case per year. *Id.* at 6 ("That means about three percent of the entire small-business population failed to receive payment in five or more bankruptcy cases over the last five years, or one or less [sic] than case per year."). Indeed, small business owners "benefit more from liberal bankruptcy laws than perhaps any other group." *Id.*

It is also untrue that the rule in the Eleventh Circuit would create for the first time a rule requiring "mountains of paperwork" or a novel federal statute of frauds. NFIB Br. 3. Until 2010, the majority of courts did in fact follow the very rule urged by the Eleventh Circuit. *See In re Powell*, 423 B.R. at 210–11. Reversal of the Eleventh Circuit is far more likely to cause disruption in the operation of the bankruptcy system.

C. Chapter 7 debtors frequently lack legal counsel for discharge litigation, which leaves them vulnerable to unwarranted settlement pressure.

The economic distress of the individual debtor, as mentioned above, also means that Chapter 7 debtors frequently lack financial resources to retain legal counsel to defend themselves from discharge challenges, whether well-grounded or not. Beginning in at least 1960, Congress became aware that the discharge provisions were being manipulated by institutional creditors who were able to intimidate honest debtors into surrendering their discharge in order to avoid litigation. It was precisely this threat of intimidation, noted by Congress in 1960 that led to one of the major reforms in discharge legislation. S. Rep. No. 86-1688 (1960). See App. 23a-24a. There is a well-documented history showing that the mere threat of a discharge challenge is often sufficient to provoke an unwarranted settlement in which the debtor surrenders his

or her discharge. Andrew F. Emerson, *So You Want to Buy a Discharge? Revisiting the Sticky Wicket of Settling Denial of Discharge Proceedings in the Chapter 7 Bankruptcy*, 92 Am. Bank. L.J. 111, 118–23 (2018).

This intimidation factor is exacerbated by the equally well-documented difficulty in providing legal representation to Chapter 7 debtors who confront discharge litigation. Legal counsel for Chapter 7 debtors frequently "unbundle" their legal services and decline to undertake representation of the debtor in an adversary proceeding challenging the discharge. "Unbundling" allows attorneys to limit the scope of their representation by excluding expensive tasks like adversary proceedings from their general services.

If a creditor challenges the discharge, an adversary proceeding may result. With these services "unbundled," a Chapter 7 debtor may have to decide whether to pay additional and indeterminate legal fees or simply allow the creditor to collect its known debt in full, thus by-passing the collective process of bankruptcy. Debtors who appear *pro se* have less favorable outcomes in judicial proceedings.[10]

The frequent inability to retain legal counsel for discharge litigation makes Petitioner's view of § 523(a)(2)(A) even more abusive. *See* William F. Stone, Jr. & Bryan A. Stark, *The Treatment of*

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[10] *See, e.g.*, Rafael I. Pardo, *An Empirical Examination of Access to Chapter 7 Relief by Pro Se Debtors*, 26 Emory Bankr. Dev. J. 5 (2009); Angela Littwin, *The Affordability Paradox: How Consumer Bankruptcy's Greatest Weakness May Account for Its Surprising Success*, 52 Wm. & Mary L. Rev. 1933, 1957 (2011) ("The percentage of pro se cases rose statistically significantly, especially among lower-income debtors, while the percentage of these cases ending with a discharge of debt declined.").

Attorneys' Fee Retainers in Chapter 7 Bankruptcy and the Problem of Denying Compensation to Debtors' Attorneys for Post-Petition Legal Services They Are Obligated to Render, 82 Am. Bankr. L.J. 551, 555 n.25 (2008).

The mere threat of discharge litigation is likely to provoke a settlement and waiver of the discharge, regardless of the merits of the discharge objection. Prior to enacting the 1978 Code, the House Judiciary Committee noted that, "[t]he threat of litigation over this [discharge] exception and its attendant costs are often enough to induce the debtor to settle for a reduced sum, in order to avoid the costs of litigation" even with respect to "marginal cases." H. Rep. No. 95-595 (1977). App. 47a-48a.

The foundation of Petitioner's argument is essentially empirical. Yet, Petitioner has not remotely shown that there is statistically significant fraud in the discharge area that justifies a narrower view of what is dischargeable. Nothing in the record before this Court, reported case law, or in Petitioner's brief justifies a harsher interpretation of § 523(a)(2)(A) based on a uniform notion of debtor misconduct and risk of fraud. Mr. Appling is an isolated case.[11] His conduct is hardly the occasion to interpret § 523(a)(2)(A) in a way that produces negative macroeconomic effects by potentially injuring the nearly one million individuals who seek bankruptcy relief each year.

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[11] "[T]he consumer bankruptcy system is generally utilized by American families in grave financial circumstances." Michael D. Sousa, *The Principle of Consumer Utility: A Contemporary Theory of Bankruptcy Discharge*, 58 U. Kan. L. Rev. 553, 614 (2010).

II. Section 523(a)(2)(A) should be interpreted broadly to mean that the exception to nondischargeability may include an oral statement about a single asset.

A. Section 523(a)(2)(A) expressly adopts a broad notion of what is dischargeable by use of the word "respecting" to modify financial condition.

The phrase "financial condition" is not defined in the Code. Instead, the Code includes a key modifier, namely, the word "respecting," which plainly connotes a broad and non-exclusive meaning. Petitioner, however, urges a "narrow" definition which essentially disregards the full import of "respecting." Pet. Br. 20–21.

Petitioner's argument that this Court disregard the term "respecting" violates a core rule of statutory construction that requires that each word be given its full meaning.[12] The term "respecting" is pivotal. "Respecting" is defined as "with respect to; with reference to; as regards." *Respecting*, *Oxford English Dictionary* (3d ed. 2010). "Respecting" is also defined to mean "[i]n relation to; regarding." Funk & Wagnalls, *Standard Encyclopedic Dictionary*, 567 (1968).[13] This means that the term "respecting" *expands* upon subsequent terms in the phrase or sentence.

"Respecting" embraces notions of being "related to." This Court has interpreted the phrase "relate[d] to"

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[12] *See, e.g.*, *Rake v. Wade*, 508 U.S. 471 (1993) ("To avoid deny[ing] effect to a part of a statute we accord significance and effect to every word.") (citations omitted).

[13] *See also*, FunkandWagnalls.com (same).

as being "deliberately expansive." *District of Columbia v. Greater Washington Bd. of Trade*, 506 U.S. 125, 129 (1992) ("We have repeatedly stated that a law 'relate[s] to' a covered employee benefit plan for purposes of [ERISA] 'if it has a connection with or reference to such a plan' . . . and thus gives effect to the 'deliberately expansive' language chosen by Congress."); *Shaw v. Delta Airlines, Inc.*, 463 U.S. 85, 96–97 (1983) (same).[14] The same is true within this Court's constitutional jurisprudence. *See Lemon v. Kurtzman*, 403 U.S. 602, 612 (1971).

Significantly, in 1987, a House Report described the discharge provision as dealing with a "false statement in writing *concerning* the debtor's financial condition . . . " H. Rep. No. 95-595 (1977). App. 44a (emphasis added). This use of "concerning," much like "respecting," shows that Congress was looking broadly and well beyond merely formal financial statements.

Petitioner argues that "respecting" is too broad when read to mean "related to," complaining that "everything is related to everything else." Pet. Br. 31. But the statute is intended to be broad. The language in § 523(a)(2) was originally an exception to the discharge and *was* broad; this key point is expressly conceded by Petitioner who notes that the precursor to this section was intended to be "as broad as its authors could do it . . . " Pet. Br. 9. Further, Petitioner's argument overlooks the important judicial ability to draw sensible lines within broad language that conform to congressional purpose. *See Lemon*, 403 U.S. at 612.

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[14] This Court also found that the phrase "in relation to" in a criminal statute clarified that a firearm "must have some purpose or effect" with respect to a drug trafficking crime. *See Smith v. United States*, 508 U.S. 223, 237 (1993) (citation omitted).

B. Prior to the adoption of the Code in 1978, most circuit courts generally interpreted "respecting financial condition" as applying to more than a formal financial statement.

The "broad" meaning of the phrase "respecting financial condition" has longstanding roots in settled case law that dates back to 1928. The phrase "respecting financial condition" first appears in H. Rep. No. 69-1257 (1926) (App. 8a) when Congress was in the process of amending what was then § 14b of the Act, which precluded a discharge of all debts for a false statement. See Act of May 27, 1926, § 6, 44 Stat. 663. App. 10a. S.G. Opp. Br. 16. (See Section III below).[15]

Following the introduction of the phrase "respecting financial condition" in 1926, the circuit courts generally interpreted this phrase broadly as meaning more than a formal financial statement. The Fourth Circuit appears to be the first circuit court to apply it. In *Lockhart v. Edel,* the Fourth Circuit held that statements made by a brokerage firm that it would purchase stock for the account of its customers upon receipt of a partial payment was false because the brokerage company was insolvent and unable to perform. *Lockhart v. Edel,* 23 F.2d 912 (4th Cir. 1928). "The representation was that the firm was in a position financially to fulfill the promise held out to its customers . . . when in fact they could not have possibly done so . . ." and hence was a statement with respect to financial condition. *Id.* at 913.

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[15] The Act was amended in 1960 so that a false statement respecting financial condition would only bar a discharge of a nonbusiness debtor of the particular debt in question. Act of July 12, 1960, Pub. L. No. 86-621, § 2(a), 74 Stat. 409. App. 33a-34a.

In 1945, the issue was given more extensive discussion by the Sixth Circuit. *See Albinak v. Kuhn*, 149 F.2d 108, 110 (6th Cir. 1945). In *Albinak*, the argument was first made that the term "financial statement" was a "term of art" that only applied to a "complete statement of assets and liabilities by which the precise financial worth of the person making the statement can be determined." *Id.* at 110.[16] The Sixth Circuit rejected this narrow view, stating, "No [case] has been found by careful examination, which confines a statement respecting one's financial condition as limited to a detailed statement of assets and liabilities." *Id.*

In 1950, the Ninth Circuit agreed. *Mau v. Sampsell*, 185 F.2d 400, 400 (9th Cir. 1950) (finding that debtor's letter "stating that an existing escrow would soon net him cash in excess of the debt" constituted a report of financial status under 11 U.S.C. § 32(c)). In 1967, the Eighth Circuit joined with the Fourth, Sixth, and Ninth Circuits on the meaning of the phrase "respecting financial condition." *See Shainman v. Shear's of Affton, Inc.*, 387 F.2d 33, 38 (8th Cir. 1967), stating, "A written statement purporting to set forth the true value of a major asset, its inventory, is a statement respecting the financial condition of that corporation." The court rejected the very argument made in this case by Petitioner: "There is nothing in the language or legislative history of this section of the Act to indicate that it was intended to apply only to complete financial statements in the accounting sense." *Id.*

Finally, shortly before the adoption of the Code in 1978, the Ninth Circuit again addressed the issue.

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[16] The court was then construing Section 14 of Chapter 3 of the Bankruptcy Act, 11 U.S.C.A § 32.

Tenn v. First Hawaiian Bank, 549 F.2d 1356, 1357–58 (9th Cir. 1977) (*per curiam*). Here, the debtors informed the bank they owned certain real property based on a deed in their favor from their mother. Shortly after the loan was made, they reconveyed the property back to their mother. The Ninth Circuit affirmed the denial of a discharge, finding that "appellants' recordation of deed . . . for the purpose of obtaining an extension of credit on the basis of [that] asset . . . was a false statement of financial condition." *Id.* at 1358.

Petitioner tries to swat away *Albinak* and *First Hawaiian Bank* but offers no analysis. Pet. Br. 44. It points to a "mine" of cases contained in a footnote which "involved" a false financial statement. That "involvement" however was not the same as a doctrinal statement within these cases that only a formal financial statement constituted a "statement respecting financial condition" under § 14 of the Act. Pet. Br. 43, n.5. Indeed, none of the cases cited in this "mine" stands for the view that the phrase "respecting financial condition" is to be narrowly interpreted as only a formal financial statement as a matter of law.

Petitioner next argues that because the purpose of the pre-1978 parallel language was to *deny* discharge, the 1978 reversal to making "statements respecting . . . financial condition" an exception to denying discharge should change the meaning of the phrase. Pet. Br. 45. However, when the 1978 Code was adopted, the view of the circuit courts was that "statements respecting . . . financial condition" did not mean merely a formal financial statement. Congress expressly stated that it did not intend to change the law in this provision. H. Rep. No. 95-595 (1977) App. 50a-51a. Thus, "there is no reason to suppose that Congress

disagreed with [pre-1978] interpretation[] when it enacted [the 1978 Code]". *Jerman v. Carlisle, McNellie, Rini, Kramer & Ulrich LPA*, 559 U.S. 573, 590 (2010). Prior construction of identical language should continue "in the absence of plain implication to the contrary." *Key v. Doyle*, 434 U.S. 59, 76 n.5 (1977) (quoting *Heald v. District of Columbia*, 254 U.S. 20 (1920)).

Following the adoption of the 1978 Code, courts continued to construe similar language in new § 523(a)(2)(B) to include written statements regarding even a single asset.[17] Until recently, the majority rule was consistent with the result reached below by the Eleventh Circuit. *See, e.g., In re Powell*, 423 B.R. at 210 (construing § 523(a)(2)(B) and holding that the majority view is the broad view).[18] Others cases were in accord. *See, e.g., In re Cook*, 46 B.R. 545, 548–49 (Bankr. E.D. Va. 1985) (list of property owned by debtor to secure a loan is a statement of a debtor's financial condition); *In re Prestridge*, 45 B.R. 681, 682 (Bankr. W.D. Tenn. 1985) (in construing § 523(a)(2)(B), the bankruptcy court acknowledged that a statement that one's assets were not encumbered qualifies as a statement respecting financial condition; "Congress did not speak in terms of financial statements. Instead it referred to a much broader class of statements.") (citations omitted); *In re Roberts*, 54 B.R.

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[17] Cases did not always distinguish between § 523(a)(2)(A) and § 523(a)(2)(B).

[18] "[T]he emerging majority of cases[ ] adopt a more liberal view. Those courts have defined the phrase to encompass a much broader class of statements, even those which relate to a single asset or liability." *In re Powell*, 423 B.R. 201, 210–11 (Bankr. N.D. Tex. 2010).

765, 769–71 (Bankr. D.N.D. 1985) (statement describing collateral pledged to bank is one concerning the debtor's financial condition).

Thus, while some more recent decisions have disagreed with the result reached by the Eleventh Circuit, the meaning of the phrase "respecting financial condition" was well settled by the circuit courts at the time of the adoption of the 1978 Code. Congress has given no indication that it intended to vary from this large body of case law.

C. The meaning of "financial condition" cannot be determined by reliance on the definition of "insolvency" in Code § 101. The definition of equitable insolvency provides a better tool for interpreting "financial condition."

Petitioner contends that the meaning of "financial condition" can be found by looking to the Code's definition of "insolvent," found in § 101(32). Cert. Pet. 19. Pet. Br. 23. Pet. Add. 12. Section 101(32) defines insolvency as a "financial condition such that" one's debts are greater than one's assets. From this they draw the untenable conclusion that since insolvency is one aspect of one's financial condition, Congress somehow meant to define "financial condition" exclusively as a statement containing all assets and liabilities.

The phrase "such that" by itself indicates that having liabilities greater than assets is but one example of a financial condition. *See Taltech Ltd. v. Esquel Enterprises Ltd.*, 410 F. Supp. 2d 977, 1003 (W.D. Wash. 2006) (defining "such that" as inclusive, not restrictive; the prior term "*creates or results in*" the subsequent term). There is nothing to suggest balance sheet insolvency is the Code's exclusive notion of a

"financial condition." Indeed, not until 2005 did any court ever suggest such an odd linkage, despite the phrase having been part of bankruptcy law since at least 1898; even then the Tenth Circuit said the relationship between the two Code sections was only "tangential." *In re Joelson*, 427 F.3d at 705.

However, if this Court determines that the definition of "insolvency" bears on this issue at all, then a far better tool is to employ the other widely-used definition in the Code, namely, equitable insolvency. Equitable insolvency has a long settled meaning of referring to a debtor's inability to pay debts as they mature. *See Moody v. Sec. Pac. Bus. Credit, Inc.*, 971 F.2d 1056, 1064 (3d Cir. 1992). This concept is incorporated into Code § 548(a)(1)(B)(ii)(III) as part of the trustee's avoidance powers. For example, a trustee may "avoid" a transfer under Chapter 5 of the Code (e.g., for a fraudulent conveyance) if at the time of the transfer the debtor intended to incur debts that were beyond its ability to pay. This has traditionally been labelled as "equitable insolvency."

"Insolvency" is a multivalent term as used in bankruptcy court. *See In re Dolata*, 306 B.R. 97, 133 (Bankr. W.D. Pa. 2004) (finding that § 548(a)(1)(B)(ii)(III) was satisfied because "the debtors either intended to incur or believed that they would incur debts that . . . would be beyond their ability to satisfy as such debts matured"); *In re Kanour*, No. 09–07030JAD, 2010 WL 8354696, at *4 n.6 (Bankr. W.D. Pa. July 1, 2010) ("Section 548(a)(1)(B)(ii) also includes relief . . . if the debtor was rendered "insolvent" in an "equitable" sense. Section 548(a)(1)(B)(ii)(III) states that a debtor may be insolvent . . . if a debtor 'intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts

matured' . . ."). *Cf. In re C.F. Foods, L.P.*, 280 B.R. 103, 117 n.30 (Bankr. E.D. Penn. 2002) (showing how the Bankruptcy Code provides "independent bases for avoiding constructively fraudulent transfers without proving balance sheet insolvency").

The notion of "insolvency" is not limited to a balance sheet test but may reflect *any aspect* of financial condition that would give rise to an inability to pay one's debts. If "insolvency" is to be used as a guide for understanding the phrase "financial condition," then it is better understood to include any statement that bears on the debtor's ability to pay or perform the underlying obligation. This could include a statement about a single asset or a combination of assets. This is precisely the argument offered by the Solicitor General, stating that an affirmative representation by a debtor qualifies as a "statement respecting the debtor's . . . financial condition" where it "relates to a debtor's financial circumstances and is offered by the debtor as evidence of his ability to pay." S.G. Opp. Br. 14. We agree.

III. The legislative history demonstrates that Congress has been expanding protection against loss of the discharge and that § 523(a)(2)(A) was intended to have a broad meaning.

The plain meaning of "respecting" and the settled case law that preceded the enactment of the 1978 Code provide this Court with a sufficient basis to affirm the Eleventh Circuit's ruling. Petitioner, however, urges a different result based on its reading of the legislative history. Pet. Br. 36 *et seq.* Petitioner focuses on the 1960 amendments to the Bankruptcy Act. It argues that Congress added the "financial condition" exception in 1960, and that it did so *only* in response to the

problem of consumer credit companies attempting to shield their claims from discharge by encouraging debtors to make false financial statements. Cert. Pet. 2. From this, it argues that Congress intended to "tweak" the "general policy" by excepting from non-discharge only a misrepresentation made in a formal financial statement. *Id.* Hence, the "narrow" rule Petitioner urges here.

Neither argument is correct. The key language that matters in this case ("respecting" and "financial condition") emerged well *before* 1960 and was *not* limited to financial statements that listed all assets and liabilities. The introduction of the phrase "financial condition" in 1898 was, from the outset, given a broad meaning, and not tethered only to formal financial statements. *See also*, Section II, above.

Nor was Congress merely "tweaking" the Act or the Code when it adopted the various amendments. Congress was responding to specific findings of creditor abuse in attempting to block discharges, as well as overly harsh interpretations of the discharge provision. Statements in the legislative history spanning from 1910 to 1978 reflect specific Congressional concern that the discharge provisions not be too "harsh," that they not make "careless" and "general statements" the basis for blocking a discharge. Congress saw the need to protect debtors from documented creditor abuse of the discharge provisions by intimidating debtors into unwarranted settlements. By 1977 the Bankruptcy Commission would recommend that Congress delete the provision *entirely*. *See* App. 47a.

A. "Financial condition" has been broadly defined since the passage of the Bankruptcy Act in 1898.

The Bankruptcy Act of 1898[19] barred a discharge completely when the debtor acted with fraudulent intent to conceal his or her "true financial condition and in contemplation of bankruptcy, destroyed, concealed or failed to keep books of account or records from which his true condition might be ascertained." Act of 1898, § 14b(2), 30 Stat. 544, 550. App. 1a. This appears to be the first use of the phrase "financial condition" in American bankruptcy law.

The reference to "true financial condition" and then to "true condition" suggests here, as elsewhere, that the real concern was with the substance of the non-disclosure, and not whether it was embodied in any particular kind of document or whether it pertained to all assets and liabilities. The term "condition" is broadly generic. Non-disclosure of a single asset could well obscure a debtor's "condition." The phrase was *not* limited to a formal financial statement when first used, let alone later. Nor was the phrase tied to "so!vency" as Petitioner later argues. Solvency may be a component, or aspect, of a "condition," but it is hardly the only such component.

The Act was amended in 1903 when Congress added language to § 14b that barred a discharge when the debtor "obtained property on credit . . . upon a materially false statement in writing made . . . for the purpose of obtaining such property . . . " Act of Feb. 5, 1903, ch. 487, 32 Stat. 797 (1903). App. 2a. Thus, as of 1903, the bar to discharge was *not* provoked by only false "financial statements" but instead, by any false

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[19] App. 1a.

statement in *writing* that was "material." There is no indication that this section only referred to a formal financial statement; then and now, the concern was with the materiality of the non-disclosure.

As early as 1910, however, Congress became aware of overly harsh interpretations of § 14b and determined that debtors needed greater protection from loss of discharge. This legislative history is described by the Fourth Circuit in *J.W. Ould Co. v. Davis*, 246 F. 228, 231 (1917). That case involved a creditor who sought to block a discharge of a merchant who had provided a false inventory to an independent credit company, which later gave the report to a creditor of the merchant. The court refused to deny the discharge. The Fourth Circuit noted the comments by the Senate Judiciary Committee, in responding to a bill passed by the House in 1910, stating as follows:

> Any tendency to make the bankrupt act unduly harsh is to be avoided. It is a sufficient ground of opposition to discharge that the bankrupt has obtained property from a creditor by a materially false statement in writing where that statement was specifically asked for by the creditor or by the creditor's representative. General statements to mercantile agencies, not specifically asked for by prospective creditors, ought not to be ground of opposition to discharge; it makes the provision too harsh, in the estimation of your committee. Merchants are likely to make careless general statements where they would be very careful were they making

> statements to creditors from whom they were at the time asking credit.

Id.[20]

Ould was not concerned with the form of the statement, but with issues of materiality and reliance. The larger question was whether a discharge could be lost through more typical, "careless" comments made by merchants. What the case recognized was that Congress and the courts did not want to make a debtor's "careless general statements" be grounds to bar a discharge. It seems unlikely that "careless general statements" were meant to denote something said *only* in a formal financial statement. Instead, the loss of the discharge should occur only upon a finding of actual reliance and materiality of the statement. This same logic pertains today.

In 1926, the word "respecting" first appears in connection with the discharge exception in a House Conference Report concerning amending § 14b of the Act. H. Rep. No. 69-1257, at 3 (1926) (Conf. Rep.). App. 8a. Section 14b of the Act was then amended to reflect these comments.[21] The 1926 amendment changed § 14b to read that a debtor may not receive a discharge of any debt if the debtor has "obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing, or causing to be made or published, *in any manner whatsoever, a materially false statement in writing respecting his financial condition*". App. 10a (emphasis added.)

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[20] The Court was evidently referring to S. Rpt. No. 61-691 (1910) App. 4a. See similar discussion in H. Rpt. No. 69-1257 (1926). App. 7a.

[21] Act of May 27, 1926, Pub. L. 69-301, 44 Stat. 662. App.10a.

Petitioner argues the 1926 amendment was added to close the so-called "loophole" in *Ould,* and thus was intended only to protect creditors against the discharge of a debt where the creditor relied on a false financial statement prepared by a debtor and given to a credit agency. Pet. Br. 8–9. Petitioner thus ignores that while Congress observed the specific problem with credit reporting agencies, its broader concern was with the general problem of creditor abuse by asserting fraud based on careless or general statements, as *Ould* makes clear. One need only look to later House Reports to see that this concern lingered over the next few decades. *See* H. Rep. No. 86-1111 (1959). App. 15a.

Nothing in the text of the 1926 amendment supports a reading that Congress was now only concerned with formal financial statements. What Congress actually wrote reflects a concern for materially false written statements of any kind and in any manner. The concern was broad and was not limited to formal financial statements. Indeed, Petitioner concedes that this amendment was drafted to be "as broad as [its authors] could do it." Pet. Br. 9. A materially false statement could be in any kind of document, including but not limited to a full financial statement. This same language remained equally broad once it became the exception to the exception.

B. In 1960 and 1978, Congress added greater debtor protection from loss of the discharge in view of creditor abuse of the discharge provisions.

In 1960 and again in 1978, Congress continued its movement toward protecting the debtor against loss of the discharge. This was largely the result of findings regarding institutional creditor abuse of the discharge provisions. Most broadly, Congress effectively rebalanced

its concerns about the "honest debtor" against the well-documented intimidation tactics of the consumer creditor institutions and its concern that "careless" comments become the basis to block a discharge.

By 1959 and 1960, both houses of Congress noted that the discharge provisions were being abused by institutional creditors who sought to intimidate debtors by threatening loss of discharge due to allegedly false statements. *See, e.g.*, S. Rep. No. 86-1688 (1960) App. 22a and H. Rep. No. 86-1111 (1959) App. 15a. Specifically, Congress observed that the consumer credit industry was abusing the discharge provisions by inducing debtors to sign incomplete and hence "fraudulent" financial statements in order to insulate themselves from having their debt discharged. *See Field*, 516 U.S. at 74–77. "Unscrupulous" lenders "armed with false financial statement[s]" could thus threaten an unwary debtor's entire discharge unless the debtor agreed to fully pay the lenders' claims after discharge. S. Rep. No. 86-1688 (1960). App. 23a.

In view of this risk of intimidation by threats of discharge litigation, Congress proposed that the Bankruptcy Act be amended so that only business debtors were subject to the complete bar to discharge due to false statements. S. Rep. No. 86-1688 (1960). App. 22a. "[T]he Committee believes that it is desirable to eliminate the false financial statement as a ground for the complete denial of a discharge insofar as the individual noncommercial bankrupt is concerned." *Id.* App. 24a. "It is also a penalty which experience has shown is subject to abuse." *Id.* App. 23a. Accordingly, the 1960 amendments transferred the language concerning false statements by individuals from § 14 (where it barred any discharge) to § 17a(2) where it now barred only the debt incurred

as a result of the false statement. Act of July 12, 1960, Pub. L. 86-621, 74 Stat. 408-409. App. 33a-34a. (*See also*, *Field*, 516 U.S. at 65–66, stating that § 17a(2) was the precursor to § 523(a)(2)(A)).

The second key turning point occurred in 1978 when the Bankruptcy Code replaced the Bankruptcy Act. Congress expressly noted its goal of modernizing bankruptcy law and addressing the "second major problem . . . [of] the inadequacy of relief that the Bankruptcy Act provides for consumer debtors." *Id.* App 41a. As Professor Ronald Mann noted, one of the central goals of the Bankruptcy Reform Act of 1978 was to provide a "broader discharge for debtors in Chapter 7." Ronald J. Mann, *Bankruptcy and the U.S. Supreme Court* 28 (2017).

Congress remained concerned over the abuse of the discharge provision concerning false statements and that an exception to discharge could be sought even where the debtor had no intent to deceive or where the "merits of the case are weak." *Id.* App. 47a-48a. Significantly, the House Report described its concern with a "false statement in writing *concerning* the debtor's financial condition . . . . " H. Rep. 95-595. App. 44a. This comment and the use of "concerning," much like "respecting," shows that Congress was looking more broadly and well beyond merely formal financial statements.

During the drafting process, Congress created the Commission on the Bankruptcy Laws of the United States to study and recommend changes to the bankruptcy laws (the "Bankruptcy Commission"). H. Rep. 95-595 (1977). App. 36a. The Bankruptcy Commission was sufficiently concerned about creditor abuse of the exception to the discharge that it "recommended that the false financial statement exception to discharge be

eliminated for consumer debts." H. Rep. 95-595. App. 47a. Rather than delete the provision, Congress adopted a compromise, but it is inconceivable that in view of the consideration to delete this provision, the upshot was a bill which made the loss of discharge by creditor aggressive conduct *more likely* rather than less likely.

The legislative history of § 523(a)(2) and its predecessors fully reflect that Congress has consistently moved toward greater protection of the discharge. Petitioner's brief suggests a narrative of Congress moving in the opposite direction and making discharge less available. Yet, Petitioner does not dispute that the legislative history contains a detailed discussion of Congress' concern over creditor abuse of the discharge provisions. Congress' response to this abuse was to provide broader protection against loss of the discharge, not to re-define the established meaning of "financial condition." This concern over creditor abuse hardly squares with Petitioner's conclusion that Congress therefore must have meant to give the very same institutional creditors *greater* leverage and intimidation opportunities by now making oral statements on "financial condition" the easy prey for a discharge challenge.

CONCLUSION

For the foregoing reasons, the decision of the Eleventh Circuit should be affirmed.

Respectfully submitted,

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APPENDIX

APPENDIX

Bankruptcy Act of 1898, 30 Stat. 544

* * *

SEC. 14. DISCHARGES, WHEN GRANTED.—a Any person may, after the expiration of one month and within the next twelve months a: subsequent to being adjudged a bankrupt, file an application for a disc barge in the court of bankruptcy in which the proceedings are pending ; if it shall be made to appear to the judge that the bankrupt was unavoidably prevented from filing it within such time, it may be filed within but not after the expiration of the next six months.

b The judge shall hear the application for a discharge, and such proofs and pleas as may be made in opposition thereto by parties in interest, at such time as will give parties in interest a reasonable opportunity to be fully heard, and investigate the merits of the application and discharge the applicant unless he has (1) committed an offense punishable by imprisonment as herein provided; or (2) with fraudulent intent to conceal his true financial condition and in contemplation of bankruptcy, destroyed, concealed, or failed to keep books of account or records from which his true condition might be ascertained.

c The confirmation of a composition shall discharge the bankrupt from his debts, other than those agreed to be paid by the terms of the composition and those not affected by a discharge.

* * *

Act of February 5, 1903, 32 Stat. 797

Approved, February 5, 1903.

CHAP. 487.—An Act To amend an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States," approved July first, eighteen – hundred and ninety-eight.

* * *

SEC. 4. That subdivision b of section fourteen of said Act be, and the same is hereby, amended so as to read as follows:

"b The judge shall hear the application for a discharge, and such proofs and pleas as may be made in opposition thereto by parties in interest, at such time as will give parties in interest a reasonable opportunity to he fully heard, and investigate the merits of the application and discharge the applicant unless he has (1) committed an offense punishable by imprisonment as herein provided; or (2) with intent to conceal his financial condition, destroyed, concealed, or failed to keep books of account or records from which such condition might be ascertained; or (3) obtained property on credit from any person upon a materially false statement in writing made to such person for the purpose of obtaining such property on credit; or (4) at any time sub sequent to the first day of the four months immediately preceding the filing of the petition transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed any of his property with intent to hinder, delay, or defraud his creditors; or (5) in voluntary proceedings been granted a discharge in bankruptcy within six years; or (8) in the course of the proceedings in bankruptcy ref used to obey any lawful order of or

to answer any material question approved by the court."

SEC. 5. That section seventeen of said Act be, and the same is hereby, amended so as to read as follows:

SEC. 17. DEBTS NOT AFFECTED BY A DISCHARGE.—a A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as (1) are due as a tax levied by the United States, the State, county, district, or municipality in which he resides; (2) are liabilities for obtaining property by false pretenses or false representations, or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; or (4) were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity."

* * *

SENATE

61ST CONGRESS **REPORT**
2d Session **No. 691**

AMENDMENT OF THE BANKRUPTCY ACT

MAY 16, 1910.—Ordered to be printed.

Mr. BACON, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany H.R. 20575.]

The Committee on the Judiciary, to whom was referred the bill (H.R. 20575) entitled "An act to amend an act entitled 'An act to establish a uniform system of bankruptcy throughout the United States,' approved July 1, 1898, as amended," etc., have had the same under consideration, and report it back with amendments.

The report of the Judiciary Committee of the House of Representatives on said bill is hereby concurred in with the additions and reservations hereinafter indicated and explained in connection with the different sections treated. That report states:

The experience of the seven years elapsing since the amendment of February 5, 1903, in the administration of the bankruptcy law has developed certain defects which seem to the committee to require additional legislation to reconcile conflicting decisions of the courts, to make the law more just to debtor and creditor, and also to correct certain faults in its administrative features, which, despite the obvious intention of

the framers of the present law as well as of those who framed the amendment of 1903, have crept in through loopholes that have developed. Hence the introduction and approval of the bill which this report accompanies. In explanation of this bill the following statement is submitted:

* * *

Section 6. The House bill seeks to make three changes in subdivision–b of section 14 of the present law, relative to opposition to discharge. First, it provides that trustees shall be competent "parties in interest" to object to a discharge; second, that they can so object only when authorized at a meeting of creditors; and, third, that a materially false mercantile statement, if made to the trade and relied on by the creditor, shall be an available objection to the debtor's discharge.

Your committee concur in the first two of these changes, but do not concur in the last.

The first of these changes, making the trustee a competent party to oppose a bankrupt's discharge, is a desirable change, as thereby the expense of the proceedings in opposition to discharge will ho spread over all of the creditors, and not be borne by a single creditor who may file objections. Moreover, it lessens the danger of improper oppositions to discharge by single creditors for the purpose of forcing settlements.

The second change, namely, that, the trustee can only oppose discharge when authorized to do so at a meeting of creditors, is also desirable, affording a proper check upon improvident and improper opposition to discharge. In view of the fact that "entry of appearance" in opposition to discharge must be made at the return tune of the ten days' notice provided

by section 58, but that the meeting of creditors for authorizing such opposition also must be upon ten days' notice—thus preventing creditors meetings being held before the expiration of the time for entering appearance in opposition—it has been found necessary to amend section 58 by providing for thirty days' notice of the filing of discharge applications in the place of the ten days' notice at present prescribed, in this way sufficient time being given for the creditors to hold their meeting.

The third change made by the House bill, that which in effect would make the obtaining of property on false written statements to mercantile agencies ground of opposition to discharge, without the creditor whose property has thus been obtained first asking such mercantile agencies to procure him the written statement, is not concurred in by your committee. Any tendency to make the bankrupt act unduly harsh is to be avoided. It is a sufficient ground of opposition to discharge that the bankrupt has obtained property from a creditor by a materially false statement in writing where that statement was specifically asked for by the creditor or by the creditor's representative. General statements to mercantile agencies, not specifically asked for by prospective creditors ought not to be ground of opposition to discharge; it makes the provision too harsh, in the estimation of your our committee. Merchants are likely to make careless general statements where they would be very careful were they making statements to creditors from whom they were at the time asking credit.

Your committee propose a substitute for the House amendment of this ground of opposition to discharge, which is thought to go as far as is proper.

* * *

HOUSE OF REPRESENTATIVES

69TH CONGRESS **REPORT**
1st Session **No. 1257**

ESTABLISH A UNIFORM SYSTEM OF BANKRUPTCY

MAY 19, 1926.—Ordered to be printed

Mr. CHRISTOPHERSON, from the committee of conference, submitted the following

CONFERENCE REPORT
(To accompany S. 1039]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the House to the bill (S. 1039) entitled, "To amend an act entitled, 'An act to establish a uniform system of bankruptcy throughout the United States', approved July 1, 1898, and acts amendatory thereof and supplementary thereto, "having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the Senate recede from its disagreement to the amendment of the House and agree to the same with the following amendments:

In lieu of the matter proposed to be inserted by said amendment insert the following:

* * *

Sec. 6. That section 14 (a) and (b) of said act, as 80 amended, be, and the same hereby is, amended to read as follows:

"(a) Any person may, after the expiration of one month and within twelve months, subsequent to being adjudged a. bankrupt, file an *application for a discharge in the court of bankruptcy in which the proceedings are pending, if it shall be made to appear to the judge that the bankrupt aas unavoidably prevented from filing it within such time, it may be wled within but not after the expiration* of *the next six months.*

"(b). The judge shall hear the application for a discharge and such proofs and pleas as may be made in opposition thereto by the trustee or other parties in interest, at such time as will give the trustee or parties in interest a reasonable opportunity to be fully heard; and investigate the merits of the application and discharge the applicant, unless he has (1) committed an offense punishable by imprisonment as herein provided; or (2) destroyed, mutilated, falsified, concealed, or failed to keep books of account, or records, from which his financial condition and business transactions might be ascertained; unless the court deem such failure or acts to have been justified, under all the circumstances of the case; or (3) obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing, or causing to be made or published, in any manner whatsoever, a materially false statement in writing respecting his financial condition; or (4) at any time subsequent to the first day of the twelve months immediately preceding the filing of the petition, transferred, removed, destroyed, or concealed or permitted to be removed, destroyed, or concealed any of his property, with intent to hinder, delay, or defraud his creditors; or (5) has been granted a discharge in bankruptcy within six years; or (6) in the course of proceedings in bankruptcy, refused to obey any lawful order of or to answer any material question approved by the court; or (7) has failed to explain

satisfactorily any losses of assets or deficiency of assets to meet his liabilities: Provided, That if, upon the hearing of: an objection to a discharge the objector shall show to the satisfaction of the court, that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this paragraph (b), would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt: And provided further, That the trustee shall not interpose objections to a bankrupt's discharge until he shall be authorized so to do by the creditors at a meeting of creditors called for that purpose on the application of any creditor."

* * *

Act of May 27, 1926, 44 Stat. 662

* * *

Sec. 6. That section 14 (a) and (b) of said Act, as so amended, be and the same hereby is, amended to read as follows:

"(a) Any person may, after the expiration of one month an within twelve months, subsequent to being adjudged a bankrupt, file an application for a discharge in the court of bankruptcy in which the proceedings are pending, if it shall be made to appear to the judge that the bankrupt was unavoidably prevented from filing it within such time, it may be filed within but not after the expiration of the next six months.

"(b) The judge shall hear the application for a discharge and such proofs and pleas as may be made in opposition thereto by the trustee or other parties in interest, at such time as will give the trustee or parties in interest a, reasonable opportunity to be fully heard; and investigate the merits of the application and discharge the applicant, unless he has (1) committed an offense punishable by imprisonment as herein provided; or (2) destroyed, mutilated, falsified, concealed, or failed to keep books of account, or records, from which his financial condition and business transactions might be ascertained; unless the court aeon such failure or acts to have been justified, under all the circumstances of the case; or (3) obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing, or causing to be made or published, in any manner whatsoever, a, materially false statement in writing respecting his financial condition; or (4) at any time subsequent to

the first day of the twelve months immediately preceding the filing of the petition, transferred, removed, destroyed, or concealed or permitted to be removed, destroyed, or concealed any of his property, with intent to hinder, delay, or defraud his creditors; or (5) has been granted a discharge in bankruptcy within six years; or (6) in the course of proceedings in bankruptcy, refused to obey any lawful order of or to answer any material question approved by the court; or (7) has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities: *Provided,* That if, upon the hearing of an objection to a discharge, the objector shall show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this paragraph (b), would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt: *And provided further,* That the trustee shall not interpose objections to a bankrupt's discharge until he shall be authorized so to do by the creditors at a meeting of creditors called for that purpose on the application of any creditor."

* * *

Act of June 22, 1938, Pub. L. No. 75-696, 52 Stat. 850

* * *

"SEC. 14. DISCHARGES, WHEN GRANTED.—a. The adjudication of any person, except a corporation, shall operate as an application for a discharge: *Provided,* That the bankrupt may, before the hearing on such application, waive by writing, filed with the court, his right to a discharge. A corporation may, within six months after its adjudication, file an application for a discharge in the court in which the proceedings are pending.

"b. After the bankrupt shall have been examined, either at the first meeting of creditors or at a meeting specially fixed for that purpose, concerning his acts, conduct, and property, the court shall make an order fixing a time for the filing of objections to the bankrupt's discharge, notice of which order shall be given to all parties in interest as provided in section 58 of this Act. Upon the expiration of the time fixed in such order or of any extension of such time granted by the court, the court shall discharge the bankrupt if no objection has been filed ; otherwise, the court shall hear such proofs and pleas as may be made in opposition to the discharge, by the trustee, creditors, the United States attorney, or such other attorney as the Attorney General may designate, at such time as will give the bankrupt and the objecting parties a reasonable opportunity to be fully heard.

"c. The court shall grant the discharge unless satisfied that the bankrupt has (1) committed an offense punishable by imprisonment as provided under this Act; or (2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of account or records,

from which his financial condition and business transactions might be ascertained, unless the court deems such acts or failure to have been justified under all the circumstances of the case; or (3) obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition; or (4) at any time subsequent to the first day of the twelve months immediately preceding the filing of the petition in bankruptcy, transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed, or concealed, any of his property, with intent to hinder, delay, or defraud his creditors; or (5) has within six years prior to bankruptcy been granted a discharge, or had a composition or an arrangement by way of composition or a wage earner's plan by way of composition confirmed under this Act; or (6) in the course of a proceeding under this Act refused to obey any lawful order of, or to answer any material question approved by, the court; or (7) has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities: *Provided,* That if, upon the hearing of an objection to a discharge, the objector shall show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this subdivision c, would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt.

"d. When requested by the court, the United States attorney, located in the judicial district in which the bankruptcy proceeding is pending, or such other attorney as the Attorney General may designate, shall examine into the acts and conduct of the bankrupt

and, if satisfied that probable grounds exist for the denial of the discharge and that the public interest so warrants, he shall oppose the discharge of such bankrupt in like manner as provided in the case of a trustee.

* * *

HOUSE OF REPRESENTATIVES

86TH CONGRESS **REPORT**
1st Session **No. 1111**

LIMITING THE USE OF FALSE FINANCIAL STATEMENTS AS A BAR TO DISCHARGE IN BANKRUPTCY

SEPTEMBER 1, 1959.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. FORRESTER, from the Committee on the Judiciary, submitted the following

REPORT

(To accompany H.R. 4346]

The Committee on the Judiciary, to whom was referred the bill (H.R. 4340) to amend the Bankruptcy Act to limit the use of false financial statements as a bar to discharge, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

On page 2, line 16, strike out "defraud" and substitute "deceive".

On page 2, line 25, strike out "or".

On page 3, line 2, strike out "or" where it appears before (5).

EXPLANATION OF AMENDMENTS

During the subcommittee hearings, objection was expressed to the use of the word "defraud" rather than "deceive". The committee is of the view that in the context of this bill the words "defraud" and "deceive" may be defined in terms of each other. The committee,

therefore, has no objection to substituting "deceive" for "defraud".

The second and third amendments are technical amendments.

PURPOSE

The purpose of this bill is to eliminate as a ground for the complete denial of a discharge the obtaining of money or credit through false financial statements issued by a nonbusiness bankrupt.

GENERAL STATEMENT

Section 14c(3) of the Bankruptcy Act now provides that—

> The court shall grant the discharge unless satisfied that the bankrupt has * * * obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing, or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition; * * *."

Section 17a(2) provides that—

> A discharge in bankruptcy shall release a bankrupt from all of his provable debts * * * except such as * * * are liabilities for obtaining money or property by false pretenses or false representations * * *."

Thus, an obligation incurred on the basis of a false financial statement may result either in the nondischargeability of the particular debt or in the complete denial of a discharge.

The committee believes that complete denial of a discharge is too severe a penalty in the case of the

individual noncommercial bankrupt. It is also a penalty which experience has shown to be subject to abuse. An unscrupulous lender armed with a false financial statement has a powerful weapon with which to intimidate a debtor into entering into an agreement in which the creditor agrees not to oppose the discharge in return for the debtor's agreement to pay the debt in full after discharge. The creditor may also accomplish his purpose of preserving his debt by not opposing the discharge and then suing in a State court on the ground that the debt is not dischargeable. Testimony before the Subcommittee on Bankruptcy and Reorganization by experts in bankruptcy law indicates that unscrupulous lenders have frequently condoned, or even encouraged, the issuance of statements omitting debts with the deliberate intention of obtaining a false agreement for use in the event that the borrower subsequently goes into bankruptcy.

Even where the creditor has had no part in the issuance of a false financial statement, the exercise of his right to bar the discharge completely results in a windfall for other creditors who were not even aware of such a statement, Debts which are dischargeable are not discharged solely because one of many debts was induced by a false financial statement. This result is not required to protect a creditor who has relied on a false financial statement since under section 17a(2) that particular debt is not dischargeable.

In view of the protection which section 17a(2) gives to the creditor, and in view of the abuses which have grown out of section 14c(3), the committee believes that it is desirable to eliminate the false financial statement as a ground for the complete denial of a discharge insofar as the individual noncommercial bankrupt is concerned.

The situation is somewhat different in the case of a business bankrupt. The businessman is more likely to be aware of the severe consequences to him of issuing a false financial statement. His ordinary business records enable him to produce a more accurate statement than a householder who may have a multitude of small debts and no records. Furthermore, the financial statement issued by a businessman is frequently for the purpose of establishing credit standing in the community. His creditors may never see the financial statement itself. On the other hand, the nonbusiness debtor normally issues his financial statement to a particular creditor as part of his application for credit or for a loan. That creditor already has the protection of nondischargeability under section 17.

The bill, therefore, amends section 14c(3) to authorize the denial of a discharge only where the bankrupt has incurred an obligation—

> while engaged in business as a sole proprietor, partnership, or as an executive of a corporation * * *.

The bill also amends section 17a(2) by adding the language:

> or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to defraud.

The purpose of this amendment is to assure that although the obtaining of money or property on credit through the issuance of a false financial statement is no longer to be a ground for denial of a discharge to a

nonbusiness bankrupt, any obligation incurred as a result of such a statement is to be nondischargeable under section 17. The addition of the elements of reliance by the creditor and intent to deceive by the debtor are merely enactments of existing case law.

This bill has the support of the Judicial Conference of the United States and the National Bankruptcy Conference. During the 85th. Congress, H.R. 106, a bill dealing with this problem in a somewhat broader fashion, passed the House but was riot acted on in the Senate.

CHANGES IN EXISTING LAW

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, there is printed below in roman type without brackets existing law in which no change is proposed by enactment of the bill here reported; present provisions proposed to he stricken are enclosed in black brackets; and new provisions proposed to be inserted are shown in italic:

SECTION 14c(3) OF THE BANKRUPTCY ACT

SEC. 14. DISCHARGES WHEN GRANTED.—a. * * *

b. * * *

c. The court shall grant, the discharge unless satisfied that the bankrupt lies (1) committed an offense punishable by imprisonment as provided under title 18, United States Code, section 152; or (2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of accounts of records, from which his financial condition and business transactions might be ascertained, unless the court deems such acts or failure to have been justified under all the circumstances of the ease; or (3) (obtained money or property on

credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition;] *while engaged in business as a sole proprietor, partnership, or as an executive of* a *corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation;* * * *.

SECTION 17a OF THE BANKRUPTCY ACT

SEC. 17. DEBTS NOT AFFECTED BY A DISCHARGE.—a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; (2) are liabilities for obtaining money or property by false pretenses or false representations, *or for obtaining money or property on credit or obtaining an extension. or renewal of credit in. reliance upon a materially ,false statement in writing respecting his financial condition made or published or caused to be made or published in. any manner whatsoever with intent to deceive,* or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor, if known to the bankrupt, unless such creditor had

notice or actual knowledge of the proceedings in bankruptcy; [or] (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; [or] (5) are for wages which have been earned within three months before the date of commencement of the proceedings in bankruptcy due to workmen, servants, clerics, or traveling or city salesmen, on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; or (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment.

SENATE

86TH CONGRESS
2nd Session

REPORT
No. 1688

LIMITING THE USE OF FALSE FINANCIAL STATEMENTS AS A BAR TO DISCHARGE IN BANKRUPTCY

JUNE 24, 1960—Ordered to be printed

Mr. HRUSKA, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany H.R. 4346]

The Committee on the Judiciary, to which was referred the bill (H.R. 4346) to amend the Bankruptcy Act to limit the use of false financial statements as a bar to discharge, having considered the same, reports favorably thereon, without amendment, and recommends that the bill do pass.

PURPOSE

The purpose of the bill is to limit the use of false financial statements as a bar to discharge in bankruptcy.

STATEMENT

The Administrative Office of the U.S. Courts recommends the bill favorably.

Section 14 of the Bankruptcy Act, entitled "Discharges, When Granted," now provides in c(3) that the court shall grant the discharge unless satisfied that the bankrupt has—

> obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing, or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition;

The bill would substitute in lieu of this the following language—

> while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation;

The Committee on the Judiciary of the House of Representatives in favorably reporting the bill has commented as follows in regard to this change:

> The committee believes that complete denial of a discharge is too severe a penalty in the case of the individual noncommercial bankrupt. It is also a penalty which experience has shown to be subject to abuse. An unscrupulous lender armed with a false financial statement has a powerful weapon with which to intimidate a debtor into entering into an agreement in which the creditor agrees not to oppose the discharge in return for the debtor's agreement to pay the debt in full after discharge. The creditor may also accomplish his purpose of preserving his

debt by not opposing the discharge and then suing in a State court on the ground that the debt is not dischargeable. Testimony before the Subcommittee on Bankruptcy and Reorganization by experts in bankruptcy law indicates that unscrupulous lenders have frequently condoned, or even encouraged, the issuance of statements omitting debts with the deliberate intention of obtaining a false agreement for use in the event that the borrower subsequently goes into bankruptcy.

Even where the creditor has had no part in the issuance of a false financial statement, the exercise of his right to bar the discharge completely results in a windfall for other creditors who were not even aware of such *a* statement. Debts which are dischargeable are not discharged solely because one of many debts was induced by a false financial statement. This result is not required to protect a creditor who has relied on a false financial statement since under section 17a (2) that particular debt is not dischargeable.

In view of the protection which section 17a(2) gives to the creditor, and in view of the abuses which have grown out of section 14c(3), the committee believes that it is desirable to eliminate the false financial statement as a ground for the complete denial of a discharge insofar as the individual noncommercial bankrupt is concerned.

The situation is somewhat different in the case of a business bankrupt. The businessman is more likely to be aware of the severe consequences to him of issuing a false

> financial statement. His ordinary business records enable him to produce a more accurate statement than a householder who may have a multitude of small debts and no records. Furthermore, the financial statement issued by a businessman is frequently for the purpose of establishing credit standing in the community. His creditors may never see the financial statement itself. On the other hand, the nonbusiness debtor normally issues his financial statement to a particular creditor as part of his application for credit or for a loan. That creditor already has the protection of nondischargeability under section 17.

The bill also amends section 17 of the Bankruptcy Act, entitled, "Debts Not Affected by a Discharge," by adding in a(2) the following new language—

> or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive,

The Committee on the Judiciary of the House of Representatives in its report on the bill has commented in regard to this addition—

> The purpose of this amendment is to assure that although the obtaining of money or property on credit through the issuance of a false financial statement is no longer to be ground for denial of a discharge to a nonbusiness bankrupt, any obligation

> incurred as a result of such a statement to be nondischargeable under section 17. The addition of the elements of reliance by the creditor and intent to deceive by the debtor are merely enactments of existing case law.

The committee believes that the bill as recommended by the Administrative Office of the U.S. Courts and as passed by the House of Representatives is meritorious and recommends it favorably.

Attached and made a part of this report are (1) a letter, dated January 15, 1960, from the Administrative Office of the U.S. Courts; (2) a letter, dated March 21, 1960, from the Secretary of the Treasury; (3) a letter, dated June 1, 1960, from the Department of Justice; and (4) a letter, dated June 13, 1960, from the American Bankers Association.

ADMINISTRATIVE OFFICE OF THE U.S. COURTS,
Washington, D.C., January 15, 1960

Hon. JAMES O. EASTLAND,
Chairman, Committee on the Judiciary.
U.S. Senate, Washington, D.C.

DEAR SENATOR EASTLAND: The bill (H.R. 4316) to amend the Bankruptcy Act to limit the use of false financial statements as a bar to discharge was on September 1, 1959, reported favorable by the House Judiciary Committee to the House with minor amendments (H. Rept. 1111). It passed the House as reported on September 7, 1959, and it is now pending before the Senate Judiciary Committee. The amendments arc stated in the House report as follows:

On page 2, line 16, strike out "defraud" and substitute "deceive".

On page 2, line 25, strike out "or".

On page 3, line 2, strike out "or" where it appears before (5).

During the subcommittee hearings, objection was expressed to the use of the word "defraud" rather than "deceive." The committee was of the view that in the context of the bill the words "defraud" and "deceive" may be defined in terms of each other and it, therefore, had no objection to substituting "deceive" for "defraud."

The second and third amendments are merely technical amendments.

The Judicial Conference at its March 1959 meeting reaffirmed its approval of the language contained in the original bill, H.R. 4346. In view of this and since the amendments made by the House are of a clarifying or technical nature we hope the bill will be enacted into law as so amended.

Sincerely yours,

AUBREY GASQUE,
Assistant Director.

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, March 21, 1960.

Hon. JAMES O. EASTLAND,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, D.C.

MY DEAR MR, CHAIRMAN: This is in response to your request for the Department's views on H.R. 4346, to amend the Bankruptcy Act to limit the use of false financial statements as a bar to discharge.

The proposed legislation amends section 14c(3) of the Bankruptcy Act. (11 U.S.C. 32(c) (3) to eliminate as a ground for the denial of a discharge, insofar as the nonbusiness bankrupt is concerned, the obtaining of money or credit through false financial statements. It further amends section 17a(2) of the act (11 U.S.C. 35(a)(2) to make clear that, although the obtaining of money or property on credit through the issuance of a false financial statement is no longer to be a ground for denial of a discharge to a nonbusiness bankrupt, the particular obligation incurred as a result of such a statement is to remain nondischargeable.

The subject matter of this bill does not appear to have any adverse effect upon the treatment of Federal tax claims in Bankruptcy Act proceedings. Accordingly, the Treasury Department expresses no views on the merits of H.R. 4346.

The Bureau of the Budget has advised the Treasury Department that there is no objection to the presentation of this report.

Sincerely yours,

JAY W. GLASMANN,
Assistant to the Secretary.

U.S. DEPARTMENT OF JUSTICE,
Washington, D.C., June 1, 1960.

Hon. JAMES O. EASTLAND,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, D.C.

DEAR SENATOR: This is in response to your request for the views of the Department of Justice concerning (H.R. 4346) to amend the Bankruptcy Act to limit the use of false financial statements as a bar to discharge.

Section 14c(3) of the Bankruptcy Act (30 Stat. 550, as amended; 11 U.S.C. 32(c)(3)) provides that a discharge in bankruptcy shall be refused if the court is satisfied that the bankrupt obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published a materially false financial statement in writing.

The bill would amend the section to limit this ground for denying a discharge to bankrupts who furnished such false statements while engaged in business as a sole proprietor, partnership, or an executive of a corporation.

The bill would also amend section 17 of the Bankruptcy Act (30 Stat. 550, as amended; 11 U.S.C. 55(a)), which now provides in part that a discharge does not release a bankrupt from debts which are liabilities for obtaining money or property by false pretenses or false representations. Under the proposed amendment, liabilities for obtaining money or property on credit, or obtaining an extension or a renewal of credit, by furnishing false financial statements would similarly be unaffected by the discharge.

The subject of this legislation is not a matter for which the Department of Justice has primary responsibility, and accordingly we make no recommendation as to the enactment of the bill.

The Bureau of the Budget has advised that there is no objection to the submission of this report.

Sincerely yours,

JOHN D. CALHOUN,
Acting Deputy Attorney General.

THE AMERICAN BANKERS ASSOCIATION,
WASHINGTON OFFICE,
Washington, D.C., June 13, 1960.

Re H.R. 4846.
Hon. JAMES O. EASTLAND,
Chairman, Senate Judiciary Committee,
New Senate Office Building, Washington. D.C.

DEAR SENATOR EASTLAND: In a letter dated January 13, I indicated that the American Bankers Association objected to enactment of H.R. 43-16, which amends the Bankruptcy Act. The association has reconsidered this legislation, and I am authorized to advise you that the association is removing its objection to enactment of H.R. 4346.

Sincerely yours,

J. OLNEY BROTT.

CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rifles of the Senate, changes in existing law made by the bill: as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman) :

SECTION 14c(3) or THE BANKRUPTCY ACT

SEC. 14. DISCHARGES, WHEN GRANTED.—a. * * *

b. * * *

c. The court shall grant the discharge unless satisfied that the bankrupt has (1) committed an offense punishable by imprisonment as provided under title 18, United States Code, section 152; or (2) destroyed, mutilated, falsified, concealed, or failed to keep or preserve books of accounts of records, from which his financial condition and business transactions might be ascertained, unless the court deems such nets or failure to have been justified under all the circumstances of the case; or (3) [obtained money or property on credit, or obtained an extension or renewal of credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition;] *while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation; * * *.*

SECTION 17a OF THE BANKRUPTCY ACT

SEC. 17. DEBTS NOT AFFECTED BY A DISCHARGE.—a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; (2) are liabilities for obtaining money or property by false pretenses or false representations, *or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive,* or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor, if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; [or] (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; [or] (5) are for wages which have been earned within three months before the date of commencement of the proceedings in bankruptcy due to workmen, servants, clerks, or traveling or city salesmen, on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; or (8) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment.

Act of July 12, 1960, Pub. L. No. 86-621 74 Stat. 408

* * *

AN ACT

To amend the Bankruptcy Act to limit the use of false financial statements as a bar to discharge.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 14c (3) of the Bankruptcy Act, as amended (11 U.S.C. 32 (c) (3)), is amended to read as follows :

> "(3) while engaged in business as a sole proprietor, partnership, or as an executive of a corporation, obtained for such business money or property on credit or as an extension or renewal of credit by making or publishing or causing to be made or published in any manner whatsoever a materially false statement in writing respecting his financial condition or the financial condition of such partnership or corporation: or"

SEC. 2. Subdivision a. of section 17 of the Bankruptcy Act, as amended (11 U.S.C. 35a), is amended to read as follows:

> "a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an exten-

sion or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for ,seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversation; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity ; (5) are for wages which have been earned within three months before the date of commencement of the proceedings in bankruptcy due to workmen, servants, clerks, or traveling or city salesmen, on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt or (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment."

Approved July 12, 1960.

Public Law 86-622

HOUSE OF REPRESENTATIVES

95th Congress **Report**
1st Session **No. 95-595**

BANKRUPTCY LAW REVISION

September 8, 1977.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed.

Mr. Edwards of California, from the Committee on the Judiciary, submitted the following

REPORT OF THE COMMITTEE ON THE JUDICIARY together with SEPARATE SUPPLEMENTAL, AND SEPARATE ADDITIONAL VIEWS

[Including Cost Estimate of the Congressional Budget Office]

[To accompany H.R. 8200]

The Committee on the Judiciary, to whom was referred the bill (H.R. 8200) to establish a uniform law on the subject of Bankruptcies, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass. The committee amendment strikes out all after the enacting clause and inserts a new text, which appears in italic type in the reported bill.

The amendment is an amendment in the nature of a substitute for the bill, incorporating six substantive amendments adopted by the committee, and numerous technical, drafting, and style changes to the bill. A detailed description of the six amendments adopted

during committee deliberations is incorporated into the description of the bill contained in this Report, which addresses itself to the amendments in the nature of a substitute. Briefly summarized, they are as follows:

* * *

Introduction
I. History

In 1970, congress created the commission on the bankruptcy laws of the United States to study and recommend changes in the bankruptcy laws.[1] The commission became operational in June, 1971, and filed its final report with the Congress on July 30, 1973.[2] Its report was in two parts. Part I contained the Commission's findings and recommendations. Part II contained a draft of a bill to implement those recommendations. Don Edwards, Chairman of the Subcommittee on Civil and Constitutional Rights and a Member of the Commission, and Charles Wiggins, then ranking minority Member of the Subcommittee

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[1] Established by Pub. L. 91-354, Act of July 24, 1970, 84 Stat. 468, the Commission consisted of nine members. Three, including the chairman, were appointed by the President: Chairman Harold Marsh, Jr., Los Angeles, Calif.; Charles Seligson, New York, N.Y.; and Wilson Newman, Short Hills, N.J. Two each were appointed by the Speaker of the House and the President of the Senate: Hon. Don Edwards (D., Calif.), Hon. Charles E. Wiggins (R. Calif.), Hon. Quentin N. Burdick (D., N. Dak.), and Hon. Marlow W. Cook (R., Ky.). Two were appointed by the Chief Justice: Hon Edward Weinfeld (S.D.N.Y.), and Hon. Hubert L. Will (N.D. Ill.). The study leading to the creation of the Commission actually began in 1968, when the Subcommittee on bankruptcy of the Senate Committee on the Judiciary began hearings. *Hearings on S.J. Res. 100 before the Subcomm. on bankruptcy of the Senate Comm. on the Judiciary*, 90th cong., 2d sess. (1968).

[2] H.R. Doc. No. 93-137 (1973).

and also a Member of the Commission, introduced that bill in the 93d Congress as H.R. 10792.[3]

The National Conference of Bankruptcy Judges disagreed with major aspects of the Commission's bill, and drafted and proposed an alternative. The Judges bill was also introduced in the 93d congress by Messrs. Edwards and Wiggins as H.R. 16643.[4] In the 94th Congress, both of these bills were again introduced, as H.R. 31 and H.R. 32, respectively.[5]

Hearings began on both bills in the 94th Congress in May, 1975, and continued until May, 1976. The hearings were extensively publicized in the Congressional Record, and all interested parties were encouraged to present views to the Subcommittee. There were 35 days of hearings, over 100 witnesses, and over 2,700 pages of testimony.[6] The hearings covered every aspect of bankruptcy law, from the structure of the bankruptcy system to the jurisdiction of bankruptcy courts, from consumer bankruptcy to business reorganizations, from the interaction of the securities laws with bankruptcy to the tax aspects of bankruptcy, from railroad reorganization to commodity broker liquidation.

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[3] 93d Cong., 1st Sess. (1973).

[4] 93d Cong., 2d Sess. (1974).

[5] 94th Cong., 1st Sess. (1975).

[6] *Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 1st and 2d Sess., ser. 27 (1975-76). The Senate also conducted extensive hearings. *Hearings on S. 235 and S. 236 before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 94th Cong.,1st Sess. (1975).

After the hearings were completed, the process of bill drafting began. The result was H.R. 6,[7] cosponsored by Chairman Edwards, and by Mr. Butler, current ranking minority Member of the Subcommittee. Since the introduction of H.R. 6, the Subcommittee has received numerous comments from the bench, the bar, and academia.

The Subcommittee on Civil and Constitutional Rights began mark-up of the bill on March 21, 1977. Mark-up continued for 22 days, spread over eight weeks. The Members of the Subcommittee examined and discussed every one of the over 300 sections of the bill during its forty-two hours of mark-up, in addition to its debate on the bill as a whole. Over 120 amendments were proposed and debated. Over 100 were adopted. The Subcommittee completed its work on the bill on May 16, 1977, when it reported the bill favorably by a roll call vote of 7-0. The bill as amended, with numerous additional technical, drafting, and style corrections, was ordered introduced as a clean bill. Chairman Edwards, joined by the other Members of the Subcommittee, introduced H.R. 8200[8] on July 11, 1977.

The Committee on the Judiciary began deliberations on the bill on July 14, 1977, and continued work on July 15, and July 19. On July 19, the bill was ordered reported by a roll call vote of 26-3, with one Member voting present.

On July 19, the Committee was informed of a potential jurisdictional conflict with the Ways and Means Committee over certain tax provisions in the

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[7] 95th Cong., 1st Sess. (1977).

[8] 95th Cong., 1st Sess. (1977) [hereinafter cited as H.R. 8200].

bill.[9] The Chairman of the two Committees met to reach an agreement on the proper disposition of the potential claim of jurisdiction asserted by the Ways and Means Committee. Under the agreement, the Ways and Means Committee would not request a sequential referral of the bill if the Judiciary Committee made the four special tax provisions contained in the bankruptcy code proposed by the bill inapplicable to Federal Taxes.[10]

On September 8, the Committee on the Judiciary met to consider the proposal. The Committee voted to reconsider the vote to report H.R. 8200, adopted the amendment in the nature of a substitute, and once again ordered the bill reported favorably, by a roll call vote of 23-8.

II. Major Provisions

The major purpose of this bill is the modernization of the bankruptcy laws. The substantive law of bankruptcy and the current bankruptcy system was designed in 1898,[11] in the horse and buggy era of consumer and commercial credit, and was last overhauled in 1938,[12] nearly 40 years ago. It has only been since 1938 that the consumer credit industry has grown; and it has only been since the widespread adoption of the Uniform Commercial Code in the early 1960's that commercial credit has grown to its present magnitude. As the issue of bankruptcy has fallen from the national consciousness since the Great Depression in the 1930's

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[9] Letter from Chairman Al Ullman to Chairman Peter W. Rodino, Jr., July 19, 1977.

[10] H.R. 8200 § 101 (proposed 11 U.S.C. 346, 728, 1146, 1331).

[11] Act of July 1, 1898, C. 541, 30 Stat. 544.

[12] Act of June 22, 1938, C. 575, 52 Stat. 840.

the bankruptcy system has fallen into disrepair. Those once primarily responsible for its operation and maintenance, the district judges, have turned to other matters and neglected their bankruptcy responsibilities. The bankruptcy judges instead have taken over prime responsibility for the operation of the system, even though their offices are not designed statutorily to perform those duties. Both substantively and administratively, the bankruptcy system is straining on all sides to handle situations that the framers of the current law never dreamed would arise.

The Bankruptcy Commission found, and hearings before the Subcommittee on Civil and Constitutional Rights confirmed, that the most severe problem in the bankruptcy administration was the court system. The problem consists of two facets. First, the bankruptcy court today is not truly and completely a court. It is not independent. It must operate under the supervision of an unconcerned district court. This supervision has hampered bankruptcy court operations both administratively and substantively. This bill gives the bankruptcy court the independence it needs to operate in today's complex bankruptcy world.[13]

Second, the bankruptcy judge, because of the duties imposed upon him under the Bankruptcy Act, must take an active role in supervising and administering a bankruptcy case. No matter how fair a bankruptcy judge is, his statutory duties give him a certain bias in a case, and the bankruptcy court as a result has been viewed by many as an unfair forum. The bill removes many of the supervisory functions from the judge in the first instance, transfers most of them to the trustee and to the United States trustee, and involves the

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[13] *See* chapter 1, *infra*.

judge only when a dispute arises. Because the judge no longer will have to take an active role in managing bankruptcy cases, the bankruptcy court should become a forum that is fair in fact and in appearance as well.

Some of the supervisory functions removed from the judge will be transferred to a new system of United States trustees who will act as bankruptcy watchdogs, overseeing the qualifications and appointments of private trustees in bankruptcy cases, supervising their performance, monitoring their fees, and serving as trustees in cases where a private trustee cannot be found to serve.[14]

The second major problem under current bankruptcy law is the inadequacy of relief that the Bankruptcy Act provides for consumer debtors. The last major revision of the Bankruptcy Act was in 1938, before any significant amount of consumer credit had been extended. In the post-War years, consumer credit has become a major industry, and buying on time has become a way of life for a large segment of the population. The bankruptcy rate among consumers has risen accordingly, but without the required provisions in the Bankruptcy Act to protect those who need bankruptcy relief. This bill makes bankruptcy a more effective remedy for the unfortunate consumer debtor.[15]

This is not primarily a debtor's bill, however. The bill codifies creditors' rights more clearly than the case law, which is in many ways just developing. It defines the protections to which a secured creditor is entitled, and the means through which the court may grant

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[14] *See* chapter 2, *infra*.

[15] *See* chapter 3, *infra*.

that protection.[16] In the consumer area, proposed chapter 13 encourages more debtors to repay their debts over an extended period rather than to opt for straight bankruptcy liquidation and discharge.[17]

The Bankruptcy Act now contains four chapters for commercial reorganizations.[18] These chapters, and the divisions between them, were written in the 1930's, at a time when the law of commercial reorganization was little developed. The experience and development of the past forty years has made the current four chapters difficult to use, and the divisions between them have been shown to be arbitrary and of limited utility. The bill consolidates all four chapters into one business reorganization chapter (with some special provisions for railroad reorganizations) and rationalizes the various forms of relief available to a failing business, making a business reorganization a quicker, more efficient procedure, and providing greater protection for debtors, creditors, and the public interest.[19]

Commercial financing has undergone significant changes since the nearly universal adoption of the Uniform Commercial Code in the 1960's. The Bankruptcy Act has not yet been revised to account for the changes in the industry. The bill modernizes bankruptcy law in its interaction with commercial financing, in the areas of preferences and protection of both

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[16] *See* chapter 4, *infra*.

[17] *See* chapter 3, *infra*.

[18] Bankruptcy Act, cc. VII, X, XI, XII.

[19] *See* chapter 5, *infra*.

the debtor and secured creditors during a bankruptcy case.[20]

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House Report No. 95-595

Report of the Committee on the Judiciary
pp. 129-132 (continuation of previous report)

(September 8, 1977)

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The bill makes changes in other areas of the discharge. In liquidation cases, only individuals will be entitled to a discharge.[70] In reorganization and individual repayment plan cases, the existence of circumstances that would bar discharge, such as misconduct or the six-year bar, will not be a bar to confirmation of a plan.[71] As the bankruptcy commission notes:[72]

> Neither the interests of creditors nor the principles of sound bankruptcy administration requires a denial of confirmation due to conduct on the part of the debtor which would bar a discharge. If the debtor wants to pay his debts pursuant to a plan, and if the creditors are willing to go along, he should be allowed to do so. The fact that a discharge would not be available in a liquidation case should furnish a greater incentive for the debtor to perform under the plan.

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[20] *See* chapter 4, *infra*.

[70] *Id.* (proposed 11 U.S.C. 727(a)(1)).

[71] *Id* (proposed 11 U.S.C. 1129, 1141, 1325, 1328).

[72] COMMISSION REPORT, pt. I, at 175.

2. Exceptions to discharge

H.R. 8200 carries over from current law the concept that certain debts should be excepted from discharge.[73] That is, certain debts should continue to be obligations of the debtor after bankruptcy notwithstanding the bankruptcy discharge. However, the bill makes several changes in the debts excepted. Tax debts continue to be nondischargeable to a limited degree, but the time period for accumulation of taxes that are excepted from discharges is reduced in the case of all but income taxes, and the measurement of the time period is better defined.[74] Debts for alimony, maintenance, and support continue to be nondischargeable, with some changes.[75] Debts not listed by the debtor also continue to be nondischargeable, but the category of nonlisted debts is better articulated and defined.[76]

The bill continues the exception to discharge based on a false statement in writing concerning the debtor's financial condition, but with some modifications,[77] and rejects the notion that educational loans should be excepted from discharge.[78]

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[73] Bankruptcy Act § 17a, 11 U.S.C. 35(a) (1970).

[74] *Compare* H.R. 8200 § 101 (proposed 11 U.S.C. 507(6), 523(a)(11) *with* Bankruptcy Act § 17a(1), 11 U.S.C. 35(a)(1).

[75] *Compare* H.R. 8200 § 101 (proposed 11 U.S.C. 523(a)(5)) *with* Bankruptcy Act § 17a(7), 11 U.S.C. 35(a)(7). *See* Schiffman V. Wasserman, 3 Bankr. Ct. Dec. 467 (D.R.I. 1977) (Votolato, bankruptcy judge).

[76] *Compare* H.R. 8200 § 101 (proposed 11 U.S.C. 523(a)(3)) *with* Bankruptcy Act § 17a(3), 11 U.S.C. 35(a)(3).

[77] *Compare* H.R. 8200 § 101 (proposed 11 U.S.C. 523(a)(2)) *with* Bankruptcy Act § 17a(2), 11 U.S.C. 35(a)(2).

[78] *See* H.R. 8200 § 316.

a. False financial statements

A debt for obtaining money, property, or services, or an extension or renewal of credit by use of a statement in writing respecting the debtor's financial condition, that is materially false, that the debtor made or published with intent to deceive, and on which the creditor reasonably relied, is excepted from discharge under the bill.[79] The amount of the debt made non-dischargeable on account of a false financial statement is not limited to "new value" extended when a loan is rolled over. If an initial loan is made subject to a false financial statement and new money is advanced under a subsequent loan that is not made under conditions of fraud or false pretenses, then only the initial amount of the loan made on the original financial statement is invalidated and excepted from discharge. On the other hand, where the original financial statement is made under nonfraudulent conditions and the entire loan in addition to new money is advanced under a subsequent false financial statement, the entire loan is made under fraudulent conditions. This rule is sound as a matter of policy because the creditor relies to his detriment with respect to the entire amount advanced under the false financial statement. Legal rights with respect to the amount previously advanced may be altered; interest rates may be changed, maturity dates may be extended, and legal remedies may be forgone in reliance on the new false financial statement. However, if the terms of the new agreement are identical to the old agreement with respect to the old money, then no new money was obtained by a false statement on which the creditor relied since the creditor's rights were unchanged; therefore, only that portion of the false financial

[79] H.R. 8200 § 101 (propos

statement that applied to new money would be nondischargeable. In addition, the bill contains a provision that a creditor that requests a determination of the dischargeability of a consumer debt under this exception to discharge and that loses the ensuing litigation must pay the debtor's costs and attorney's fees, and may be required to pay any actual pecuniary damages resulting from the litigation.[80] Current law provides a nearly identical exception to discharge.[81] The differences are that current law does not cover a debt for services, and requires only reliance, not reasonable reliance, by the creditor on the statement. The courts have recently begun to require that the reliance be reasonable, however.[82] Current law does not, however, contain a provision granting costs, attorney's fees, and damages to a consumer debtor.

The premise of the exception to discharge is that a creditor that extended credit based on misinformation or fraudulent information transmitted by the debtor should be protected. The provision, however, has led to abuse in consumer cases, and has frustrated the fresh start goal of the bankruptcy discharge.

It is a frequent practice for consumer finance companies to take a list from each loan applicant of other loans or debts that the applicant has outstanding.[83] While the consumer finance companies use these statements in evaluating the credit risk, very often the statements are used as a basis for a false financial statement exception to discharge. The forms that the applicant fills out often have too little space for a

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[80] *Id.* (proposed 11 U.S.C. 523(d)).

[81] Bankruptcy Act § 17a(2), 11 U.S.C. 35(a)(2).

[82] *Hearings*, pt. 2, at 981-1006.

[83] *Hearings*, pt. 2, at 759-60, 942, 990-92.

complete list of debts. Frequently, a loan applicant is instructed by a loan officer to list only a few or only the most important of his debts. Then, at the bottom of the form, the phrase "I have no other debts" is either printed on the form, or the applicant is instructed to write the phrase in his own handwriting. In addition, the form states that the creditor has relied on the statement in granting the loan.

However, the creditor often has other sources of information, such as credit bureau reports, to verify the accuracy of the list of debts. Nevertheless, if the debtor files bankruptcy, creditors with these financial statements are in a position to threaten the debtor with litigation to determine the dischargeability of the debt, based on the false financial statement exception to discharge. Most often there has been no intent to deceive on the part of the debtor, and, as in so many aspects of the creditor-debtor relationship, the debtor has simply followed the creditor's instructions with little understanding of the consequences of his action.

Creditor practices in this area have been so strong that the Bankruptcy Commission recommended that the false financial statement exception to discharge be eliminated for consumer debts.[84] This bill recognizes, however, that there are actual instances of consumer fraud, and that creditors should be protected from fraudulent debtors. It retains the exception, with small modifications. But it also recognizes that the leverage creditors have over their debtors comes not so much at the stage when the loan application is made, but rather when bankruptcy ensues.

The threat of litigation over this exception to discharge and its attendant costs are often enough to

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[84] Commission Report, pt. I, at 176; pt. II, at 136.

induce the debtor to settle for a reduced sum, in order to avoid the costs of litigation. Thus, creditors with marginal cases are usually able to have at least part of their claim excepted from discharge (or reaffirmed), even though the merits of the case are weak. Statistics from a recent year, for example, show that approximately 8,000 cases were filed under this exception to discharge. Of those, over 5,000 were settled without trial. Of the remaining 3,000 creditors won just half.[85] If those 3,000 are representative, then it is likely that in 2,500 cases, debtors settled by agreeing to repay part of the debt, even though they would have won the case had it gone to trial.

In order to balance the scales more fairly in this area, H.R. 8200 adopts a compromise. The false financial statement exception is retained, and the creditor, as under current law, is required to initiate the proceeding to determine if the debt is nondischargeable. If the debtor prevails, however, the creditor is taxed costs and attorney's fees, and may be taxed any actual pecuniary damages, such as loss of a day's work, that the debtor might have suffered as a result of the litigation. The present pressure on the honest debtor to settle in order to avoid attorney's fees in litigation over a creditor—induced false statement is eliminated. The creditor is protected from dishonest debtors by the continuance of the exception to discharge.

The bill does not award the creditor attorney's fees if the creditor prevails. Though such a balance might seem fair at first blush, such a provision would restore the balance back in favor of the creditor by inducing debtors to settle no matter what the merits of their cases. In addition, the creditor is generally better able

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[85] *Hearings*, pt. 2, at 926.

to bear the costs of the litigation than a bankrupt debtor, and it is likely that a creditor's attorneys fees would be substantially higher than a debtor's, putting an additional disincentive on the debtor to litigate.

The costs-attorney's fees provision is mandatory. If the provision were made permissive instead of mandatory, with discretion in the court to award such amounts as were proper in each particular case, the debtor would once again be subject to the risk of paying attorney's fees and losing a day's work without pay. The balance would again shift back toward the creditor, and would put pressure on the debtor to settle. Making the provision discretionary would seriously weaken the protection it provides.

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House Report No. 95-595

Report of the Committee on the Judiciary
pp. 363-365 (continuation of previous report)

(September 8, 1977)

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§ *523. Exceptions to discharge*

This section specifies which of the debtor's debts are not discharged in a bankruptcy case, and certain procedures for effectuating the section. The provision in Bankruptcy Act § 17c granting the bankruptcy courts jurisdiction to determine dischargeability is deleted as unnecessary, in view of the comprehensive grant of jurisdiction prescribed in proposed 28 U.S.C. 1471(b), which is adequate to cover the full jurisdiction that the bankruptcy courts have today over dischargeability and related issues under Bankruptcy Act 17c. The Rules of Bankruptcy Procedure will specify, as

they do today, who may request determinations of dischargeability, subject, of course, to proposed 11 U.S.C. 523(c), and when such a request may be made. Proposed 11 U.S.C. 350, providing for reopening of cases, provides one possible procedure for a determination of dischargeability and related issues after a case is closed.

Subsection (a) lists eight kinds of debts excepted from discharge. Taxes that are entitled to priority are excepted from discharge under paragraph (1). In addition, taxes with respect to which the debtor made a fraudulent return or willfully attempted to evade or defeat, or with respect to which a return (if required) was not filed or was not filed after the due date and after one year before the bankruptcy case are excepted from discharge. If the taxing authority's claim has been disallowed, then it would be barred by the more modern rules of collateral estoppel from reasserting that claim against the debtor after the case was closed. *See* Plumb, *The Tax Recommendations of the Commission on the Bankruptcy Laws: Tax Procedures,* 88 Harv. L. Rev. 1360, 1388 (1975).

As under Bankruptcy Act § 17a(2), a debt for obtaining money, property, services, or an extension or renewal of credit by false pretenses, a false representation, or actual fraud, or by use of a statement in writing respecting the debtor's financial condition that is materially false, on which the creditor reasonably relied, and that the debtor made or published with intent to deceive, is excepted from discharge. This provision is modified only slightly from current section 17a(2). First, "actual fraud" is added as a grounds for exception from discharge. Second, the creditor must not only have relied on a false statement in writing, the reliance must have been reasonable. This codifies

case law construing this provision. Third, the phrase "in any manner whatsoever" that appears in current law after "made or published" is deleted as unnecessary. The word 'published' is used in the same sense that it is used in slander actions.

Unscheduled debts are excepted from discharge under paragraph (3). The provision, derived from section 17a(3), follows current law, but clarifies some uncertainties generated by the case law construing 17a(3). The debt is excepted from discharge if it was not scheduled in time to permit timely action by the creditor to protect his rights, unless the creditor had notice or actual knowledge of the case.

Paragraph (4) excepts debts for embezzlement or larceny. The deletion of willful and malicious conversion from § 17a(2) of the Bankruptcy Act is not intended to effect a substantive change. The intent is to include in the category of non-dischargeable debts a conversion under which the debtor willfully and maliciously intends to borrow property for a short period of time with no intent to inflict injury but on which injury is in fact inflicted.

Paragraph (5) excepts from discharge debts to a spouse, former spouse, or child of the debtor for alimony to, maintenance for, or support of, the spouse or child. This language, in combination with the repeal of section 456(b) of the Social Security Act (43 U.S.C. 656 (b)) by section 327 of the bill, will apply to make nondischargeable only alimony, maintenance, or support owed directly to a spouse or dependent. *See Hearings*, pt. 2. at 942. What constitutes alimony, maintenance, or support, will be determined under the bankruptcy laws, not State law. Thus, cases such as *In Re Waller*, 494 F.2d 447 (6th Cir. 1974); *Hearings*, pt. 3, at 1308-10, are overruled, and the result in cases

such as *Fife* v. *Fife*, 1 Utah 2d 281, 265 P. 2d 642 (1952) is followed. This provision will, however, make nondischargeable any debts resulting from an agreement by the debtor to hold the debtor's spouse harmless on joint debts, to the extent that the agreement is in payment of alimony, maintenance, or support of the spouse, as determined under bankruptcy law considerations that are similar to considerations of whether a particular agreement to pay money to a spouse is actually alimony or a property settlement. *See Hearings*, pt. 3, at 1287-1290.

Paragraph (6) excepts debts for willful and malicious injury by the debtor to another person or to the property of another person. Under this paragraph, "willful" means deliberate or intentional. To the extent that *Tinker* v. *Colwell*, 193 U.S. 473 (1902), 1092 held that a looser standard is intended, and to the extent that other cases have relied on *Tinker* to apply a "reckless disregard" standard, they are overruled.

Paragraph (7) excepts from discharge a debt for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, that is not compensation for actual pecuniary loss.

Paragraph (8) excepts from discharge debts that the debtor owed before a previous bankruptcy case concerning the debtor in which the debtor was denied a discharge other than on the basis of the six-year bar.

Subsection (b) of this section permits discharge in a bankruptcy case of an unscheduled debt from a prior case. This provision is carried over from Bankruptcy Act § 17b. The result dictated by the subsection would probably not be different if the subsection were not included. It is included nevertheless for clarity.

Subsection (c) requires a creditor who is owed a debt that may be expected from discharge under paragraph (2), (4), or (6) (false statements, embezzlement or larceny, or willful and malicious injury) to initiate proceedings in the bankruptcy court for an exception to discharge. If the creditor does not act, the debt is discharged. This provision does not change current law.

Subsection (d) is new. It provides protection to a consumer debtor that dealt honestly with a creditor who sought to have a debt excepted from discharge on grounds of falsity in the incurring of the debt. The debtor is entitled to costs of and a reasonable attorney's fee for the proceeding to determine the dischargeability of a debt under subsection (a)(2), if the creditor initiated the proceeding and the debt was determined to be dischargeable. The court is permitted to award any actual pecuniary loss that the debtor may have suffered as a result of the proceeding (such as loss of a day's pay). The purpose of the provision is to discourage creditors from initiating false financial statement exception to discharge actions in the hopes of obtaining a settlement from an honest debtor anxious to save attorney's fees. Such practices impair the debtor's fresh start.

§ 524. Effect of discharge

Subsection (a) specifies that a discharge in a bankruptcy case voids any judgment to the extent that it is a determination of the personal liability of the debtor with respect to a prepetition debt, and operates as an injunction against the commencement or continuation of an action, the employment of process, or any act, including telephone calls, letters, and personal contacts, to collect, recover, or offset any discharged debt as a personal liability of the debtor, or from property of the debtor, whether or not the debtor has waived

discharge of the debt involved. The injunction is to give complete effect to the discharge and to eliminate any doubt concerning the effect of the discharge as a total prohibition on debt collection efforts. This paragraph has been expanded over a comparable provision in Bankruptcy Act § 14f to cover

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Act of November 6, 1978, 92 Stat. 2590

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§ 523. Exceptions to discharge

(a) A discharge under section 727, 1141, or 1328(b) of this tale, does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

(A) of the kind and for the periods specified in section 507(a) (2) or 507(a) (6) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, if required-

(i) was not filed; or

(ii) was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

(2) for obtaining money, property, services, or an extension, renewal, or refinance of credit, by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; or

(B) use of a statement in writing-

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for obtaining such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive;

(3) neither listed nor scheduled under section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit—

(A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; or

(B) if such debt is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor had notice or actual knowledge of the case in time for such timely filing and request;

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree, or property settlement agreement, but not to the extent that—

(A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise; or

(B) such debt includes a liability designated as alimony, maintenance, or support, unless such

liability is actually in the nature of alimony, maintenance, or support;

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

(7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty—

(A) relating to a tax of a kind not specified in paragraph (1) of this subsection; or

(B) imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition;

(8) to a governmental unit, or a nonprofit institution of higher education, for an educational loan, unless—

(A) such loan first became due before five years before the date of the filing of the petition; or

(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents; or

(9) that was or could have been listed or scheduled by the debtor in a prior case concerning the debtor under this title or under the Bankruptcy Act in which the debtor waived discharge, or was denied a discharge under section 727 (a) (2), (3), (4), (5), (6), or (7) of this title, or under section 14c (1), (2), (3), (4), (6), or (7) of such Act.

(b) Notwithstanding subsection (a) of this section, a debt that was excepted from discharge under subsection (a) (1), (a) (3), or (a) (8) of this section, under section 17a(1), 17a(3), or 17a(5) of the Bankruptcy Act,

under section 4391 of the Higher Education Act of 1965 (20 1087-3), or under section 733(g) of the Public Health Services Act (42 U.S.C. 294f) in a prior case concerning the debtor under this title, or under the Bankruptcy Act, is dischargeable in a ease under this title unless, by the terms of subsection (a) of this section, such debt is not dischargeable in the case under this title.

(c) Except as provided in subsection (a) (3) (B) of this section, the debtor shall he discharged from a debt specified in paragraph (2), (4), or (6) of subsection (a) of this section. unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6), as the case may be, of subsection (a) of this section.

(d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a) (2) of this section, and such debt is discharged, the court shall grant judgment against such creditor and in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding to determine dischargeability, unless such granting of judgment would be clearly inequitable.

§ 524. Effect of discharge

(a) A discharge in a case under this title—

(1) voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 944, 1141, or 1328 of this title, whether or not discharge of such debt is waived;

(2) operates as an injunction against the commencement or continuation of an action, the employment of process, or any act, to collect, recover or offset any such debt as a personal liability of the debtor, or from property of the debtor, whether or not discharge of such debt is waived; and

(3) operates as an injunction against the commencement or continuation of an action, the employment of process, or any act, to collect or recover from, or offset against, property Of the debtor of the kind specified in section 541(a) (2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523 or 1328(c) (1) of this title, or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.

(b) Subsection (a) (3) of this section does not apply if—

(1) (A) the debtor's spouse is a debtor in a case under this title, or a bankrupt or a debtor in a case under the Bankruptcy Act, commenced within six years of the date of the filing of the petition in the case concerning the debtor; and

(B) the court does not grant the debtor's spouse a discharge in such case concerning the debtor's spouse; or

(2) (A) the court would not grant the debtor's spouse a discharge in a ease under chapter 7 of this

title concerning such spouse commenced on the date of the filing of the petition in the case concerning the debtor; and

(B) a determination that the court would not so grant such discharge is made by the bankruptcy court within the time and in the manner provided for a determination under section 727 of this title of whether a debtor is granted a discharge.

(c) An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if—

(1) such agreement was made before the granting of the discharge under section 727,1141, or 1328 of this title;

(2) the debtor has not rescinded such agreement within 30 days after such agreement becomes enforceable;

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